89-593

No. _____

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1989

LIBERTY MUTUAL INSURANCE COMPANY and
LIBERTY MUTUAL FIRE INSURANCE COMPANY,

Petitioners,

v.

COMMISSIONER OF REVENUE,
COMMONWEALTH OF MASSACHUSETTS,

Respondent.

On Petition For Writ Of Certiorari
To The Supreme Judicial Court Of Massachusetts

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Massachusetts insurance company gross investment income tax passes muster as a "franchise tax" within the meaning of (former) 31 U.S.C. § 742, and so may be imposed on the interest from United States Government bonds, contrary to the governing decisions of this Court.

2. Whether the Contracts Clause permits a state Commissioner of Revenue to administer state statutes so as to tax bonds issued by independent state authorities, even though the state Legislature and the Commissioner of Revenue's predecessor have declared those bonds to be exempt.

RULE 28.1 STATEMENT

Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company (the two Petitioners in this case) are mutual insurance companies incorporated under Massachusetts law. Neither company has any parent or other shareholders. Both companies are owned entirely by their policyholders.

A related mutual insurance company, Liberty Mutual (Bermuda) Ltd., is not a party to this case. It, too, has no shareholders; it is owned by its insured customers. Various subsidiary corporations are owned 100% (except for directors' qualifying shares) by one of the two Petitioners or by the two Petitioners collectively. Those 100%-owned subsidiaries are not included in this statement.

The other entities related to or affiliated with the Petitioners are as follows:

Stein Roe & Farnham, Inc.

Stein Roe International Growth Fund

Liberty All-Star Equity Fund

Liberty Financial Services, Inc.

Liberty Mutual U.S. Government Guaranteed Securities Income Trust

Liberty Mutual Tax-exempt Income Trust

St. James Village, Ltd. (Bermuda)

Spear Financial Services, Inc.

Except as noted, all of the above entities are U.S. domestic corporations.

TABLE OF CONTENTS

Page

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 5

I. WHETHER A STATE GROSS INCOME TAX MAY BE SUSTAINED AS A "FRANCHISE TAX" – NOTWITHSTANDING THIS COURT'S CLEAR OPINION TO THE CONTRARY IN NORTHWESTERN MUTUAL – IS AN IMPORTANT QUESTION OF FEDERAL LAW, BECAUSE THE MEANING OF THIS STATUTORY TERM HAS CONFUSED THE STATES AND REQUIRES CLARIFICATION. 7

A. THAT THE INTEREST ON FEDERAL BONDS MAY NOT BE TAXED IS A FUNDAMENTAL PRINCIPLE OF FEDERAL CONSTITUTIONAL, STATUTORY, AND DECISIONAL LAW THAT DESERVES THIS COURT'S ATTENTION AND PROTECTION. REVIEW OF THIS CASE IS NEEDED TO ACHIEVE THE LEGISLATIVE PURPOSES OF THE 1959 AMENDMENT TO 31 U.S.C. SECTION 742. 8

TABLE OF CONTENTS – Continued

Page

B. REVIEW OF THIS CASE IS NEEDED TO ASSURE COHERENCE AND CONSISTENCY IN THE APPLICATION OF 31 U.S.C. SECTION 742 14

II. WHETHER A STATE'S COMMISSIONER OF REVENUE MAY WITHOUT CONSTITUTIONAL AMENDMENT, LEGISLATION OR EVEN REGULATION DISREGARD THE RULING OF HIS PREDECESSOR AND LEGISLATION WHICH EXEMPTS THE BONDS OF INDEPENDENT AUTHORITIES IS AN IMPORTANT QUESTION UNDER THE CONTRACTS CLAUSE 20

CONCLUSION 27

TABLE OF AUTHORITIES

Page

CASES:

Allied Structural Steel Company v. Spannaus, 438 U.S. 234 (1978) 26

American Bank & Trust Co. v. Dallas County, 463 U.S. 855 (1983) ..... *passim*

American Trucking Ass'n, Inc. v. Arkansas Highway and Transp. Dept., 746 S.W.2d 377 (Ark. 1988), *cert. granted*, ___ U.S. ___, 109 S. Ct. 389 (Nov. 14, 1988), *restored for reargument*, ___ U.S. ___, 109 S. Ct. 3238 (Jul. 3, 1989)..... 20

Anderson-Cherne, Inc. v. Commissioner of Taxation, 226 N.W.2d 611 (Minn. 1975), *appeal dismissed*, 423 U.S. 886 (1975) 13, 17

Cambridge State Bank v. Roemer (District Court, Ramsey County Minnesota) (May 20, 1987) 17, 21

C.C. Collings & Co., Inc. v. Commonwealth, 488 A.2d 1187 (Cmwlth. Ct. Pa. 1984), *aff'd per curiam sub nom. Commonwealth Securities and Investments, Inc. v. Commonwealth*, 514 A.2d 1373 (Pa. 1986) 18, 21

Centerre Bank of Crane v. Director of Revenue, 744 S.W.2d 754 (Mo. 1988).....16, 20

City of El Paso v. Simmons, 379 U.S. 497 (1965) 26

Commissioner of Revenue v. Massachusetts Mutual Life Ins. Co., 384 Mass. 607 (1981)..... 1

Complete Auto Transit v. Brady, 430 U.S. 274 (1977) *passim*

Continental Bank v. Arizona Department of Revenue, 638 P.2d 228, 234 (Ariz. 1981).....5, 13

Dale National Bank v. Commissioner, 465 A.2d 965 (Pa. 1983) 17

TABLE OF AUTHORITIES – Continued

Page

Davis v. Michigan Department of Treasury, 489 U.S. ___, 108 S. Ct. ___, 103 L. Ed. 2d 891 (1989) 9

Department of Revenue v. First Union National Bank of Florida, 513 So.2d 114 (Fla. 1987), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 1253 (1988) 16, 21

Des Moines National Bank v. Fairweather, 263 U.S. 103 (1923) 12

Educational Films Corporation v. Ward, 282 U.S. 379 (1931) 12, 22

Federal Prod. Corp. v. Norberg, 429 A.2d 447 (R.I. 1981) 17

First Bank of Deer Park v. Deer Park Independent School District, 770 S.W.2d 849 (Texas Ct. of Appeals 1989) 20

First Federal Savings & Loan Ass'n v. Department of Revenue, 654 P.2d 496 (Mont. 1982), *cert. denied*, 462 U.S. 1144 (1983) 17, 18

First Federal Savings & Loan Ass'n of Philadelphia v. Commonwealth, 528 A.2d 942 (Pa. 1987). 17, 18, 19, 21

First of McAlester Corporation v. Oklahoma Tax Commission, 709 P.2d 1026 (Okla. 1985) 20

First National Bank of Atlanta v. Bartow County Board of Tax Assessors, 470 U.S. 583 (1985) 7, 10

Flint v. Stone Tracy Co., 220 U.S. 107 (1911) 13

Garfield Trust Co. v. Director, Division of Taxation, 508 A.2d 1104 (N.J. 1986), *appeal dismissed*, 479 U.S. 925 (1986) 16, 21

Helvering v. Gerhardt, 304 U.S. 405, 411-12 n.1 (1938) 10

TABLE OF AUTHORITIES – Continued

Page

Home Ins. Co. v. New York, 134 U.S. 594 (1890) ...13, 14

Indiana ex rel. Anderson v. Brand, 303 U.S. 95 (1938) 25

James B. Beam Distilling v. Georgia (Supreme Ct. of Georgia No. 46642) (July 14, 1989) 21

Macallen Company v. Massachusetts, 279 U.S. 620 (1929) 7, 22, 25

Mandel v. Bradley, 432 U.S. 173 (1977) 17

McCulloch v. Maryland, 4 Wheat 316 (1819) 8

McKesson Corp. v. Florida, 524 So.2d 1000 (Fla. 1988), *cert. granted*, ___ U.S. ___, 109 S. Ct. 389 (Nov. 14, 1988), *restored for reargument*, ___ U.S. ___, 109 S. Ct. 3238 (Jul. 3, 1989) 20

Memphis Bank & Trust Company v. Garner, 459 U.S. 392 (1983) 7, 15, 20, 21, 25, 26

Midland Financial Corp. v. Wisconsin Department of Revenue, 341 N.W.2d 397, 405 & n.10 (Wis. 1983) 13

Murray v. Charleston, 96 U.S. 432 (1878) 22

National Bank of Alaska v. State of Alaska, 769 P.2d 990 (Alaska 1989) 16

National Can Corp. v. Department of Revenue, 749 P.2d 1286 (Wash. 1988), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 2030 (1988) 21

Northwestern Mutual Ins. Co. v. Wisconsin, 275 U.S. 136 (1927) ..... *passim*

Orange Mutual Life Co. v. State Tax Commission, 283 P.2d 187, 193 (Idaho 1955) 11

Provident Institution v. Massachusetts, 6 Wall. 611 (1868) 13

TABLE OF AUTHORITIES – Continued

Page

Savings League of Wisconsin, Ltd. v. Wisconsin Dept. of Revenue, 416 N.W.2d 650 (1987), *appeal dismissed*, ___ U.S. ___, 109 S. Ct. 37 (1988) 16

Schreiner Bank v. Kerrville Independent School District, 683 S.W.2d 466 (Texas Ct. of Appeals 1984) 20

Schwinden v. Burlington Northern, Inc., 691 P.2d 1351 (Mont. 1984) 18

Society For Savings v. Bowers, 349 U.S. 143, 144 (1955) 9, 12

South Carolina v. Baker, 485 U.S. ___, 108 S. Ct. 1355 (1988) 9

State Department of Assessments and Taxation v. Maryland National Bank, 531 A.2d 294 (Md. 1987), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 2812 (1988) 16

Tradesmens National Bank of Oklahoma v. Oklahoma Tax Comm'r, 309 U.S. 560 (1940)..... 12

University v. People, 99 U.S. 309 (1879) 22

U.S. Glue Co. v. Town of Oak Creek, 247 U.S. 321, 328 (1918) 12

U.S. Trust Co. v. New Jersey, 431 U.S. 1 (1977) 26

Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956) 12, 13, 14

Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829) 8

CONSTITUTIONAL PROVISIONS:

United States Constitution, Article I, § 8, cl.2 3

United States Constitution, Article I, § 10 3

TABLE OF AUTHORITIES – Continued

Page

United States Constitution, Article VI, cl.2 3

STATUTES:

Rev. Stat. § 3701 2

28 U.S.C. § 1257 2

31 U.S.C. § 742 ..... *passim*

31 U.S.C. § 3124(a) 2

Act of February 25, 1862, Chapter 33, Section 2, 12 Stat. 346 8

Mass. G.L. c. 23A App., § 1-12; St. 1966, c. 708, § 12 23

Mass. G.L. c. 30A 25

Mass. G.L. c. 63, § 22A ..... *passim*

Mass. G.L. c. 75 App., § 1-15; St. 1960, c. 773, § 15 23

Mass. G.L. c. 81 App., § 1-13 24

Mass. G.L. c. 91 App., § 1-17 24

Mass. G.L. c. 161A, § 18; St. 1964, c. 563, § 18 22

Mass. St. 1953, c. 654; G.L. c. 14, §§ 3-4 (1953) (*superseded by* G.L. c. 14, §§ 3, 6 (1978)) 24

RULINGS AND REGULATIONS:

Ruling 1958-7, [1 Mass.] St. Tax Rep. ¶ 10-320.40 (Aug. 12, 1958) 24, 25, 26

Letter Ruling 84-61 25

Technical Information Release 85-6 25

TABLE OF AUTHORITIES – Continued

Page

MISCELLANEOUS:

Black's Law Dictionary 593 (5th ed. 1979)..... 13

Blasi and Joyce, *Bank Shares Taxation, Another Trap For the Unwary Draftsman*, 51 Tenn. L. Rev. 445, 446-47 (1984)..... 10

Blasi and Joyce, *The Franchise Tax Exception To the Federal Exemption Statute*, 102 Banking L.J. 462 (1985)..... 7

American Bank & Trust Co. v. Dallas County: The Quiet Passing Of The Separate Incidence Rule, 41 Tax Lawyer 831 (1988)..... 16

State Taxation of Bank Shares: American Bank & Trust Co. v. Dallas County, 1984 Annual Review of Banking Law 391, 398..... 9

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PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Supreme Judicial Court of Massachusetts has been reported at 405 Mass. 352 and is attached to this Petition as Appendix A. It affirmed the opinion of the Massachusetts Appellate Tax Board, which is attached to this Petition as Appendix B. Both the Supreme Judicial Court and the Appellate Tax Board relied heavily on an earlier opinion of the Supreme Judicial Court, *Commissioner of Revenue v. Massachusetts Mutual Life Ins. Co.*, 384 Mass. 607 (1981), which is attached to this Petition as Appendix C.

JURISDICTION

The judgment of the Supreme Judicial Court of Massachusetts was entered on July 11, 1989. *See* Appendix D. This Court's jurisdiction is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

During all of the years in question, Rev. Stat. § 3701, then codified as 31 U.S.C. § 742, provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

This statute is now codified at 31 U.S.C. § 3124(a), with minor amendments not relevant to this Petition. Petitioners will continue to refer to the statute as 31 U.S.C. § 742.

Petitioners challenge one branch of the insurance company tax of Massachusetts, which provides in relevant part as follows:

> Every domestic insurance company . . . shall annually pay, as part of its excise imposed under this chapter, an amount equal to *one percent of its total gross investment income* earned during the preceding calendar year, as reported in its annual statement for said year. . . .

Mass. G.L. c. 63, § 22A (emphasis added). Petitioners will refer to this branch of the Massachusetts insurance company tax as Section 22A.

The United States Constitution, Article I, § 8, cl.2, provides that Congress has power "to borrow money on the credit of the United States."

The United States Constitution, Article I, § 10, provides in relevant part that:

> No State shall . . . pass any . . . Law impairing the Obligation of Contracts.

The United States Constitution, Article VI, cl.2, provides in relevant part that:

> This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land. . . .

STATEMENT OF THE CASE

Both the Constitution of the United States and a clear federal statute forbid state income taxes on the interest from federal bonds. Massachusetts statutes similarly guarantee that the income from Massachusetts state bonds will be immune from taxation by the Commonwealth. Seeking to avoid these limitations on its authority to tax, the Commonwealth of Massachusetts has denominated a tax on the interest from federal and state bonds, not as an income tax, but as a "franchise" tax. The principal question presented by this case is whether Massachusetts or any other state can evade the protections guaranteed by federal law by the self-serving and arbitrary characterization of a tax as a "franchise" rather than as a property or an income tax.

First, Massachusetts has violated the Borrowing Clause and the Supremacy Clause of the United States Constitution by purporting to include in Section 22A the income from United States Government bonds. Section 22A, adopted in 1971, is an extraordinary tax, measured

by gross investment income without any allowance or deduction for expenses or losses, which Massachusetts imposes only on domestic insurance companies. Under the constitutional rule codified by Congress in 31 U.S.C. § 742, United States Government bonds may not be included in the measure of a state tax, either directly or indirectly, except by way of "nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations."[1]

The exception, as this Court has recognized, must be construed in a way that prevents it from swallowing the rule. Petitioners maintain that Section 22A is not a "franchise tax" within the meaning of 31 U.S.C. § 742, because a franchise tax is imposed on the value of the franchise, and gross income does not fairly measure the value of a franchise. This Court so held in *Northwestern Mutual Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927). Thus, if the statutory term "franchise tax" is anything more than an arbitrary label, 31 U.S.C. § 742 prohibits Massachusetts from taxing the interest on United States Government bonds under Section 22A. Petitioners maintain that Section 22A, either in its entirety or as applied to interest on United States Government bonds, should be struck down for violation of the Supremacy Clause and 31 U.S.C. § 742.

Second, the Massachusetts Commissioner of Revenue has violated the Contracts Clause of the United States Constitution by purporting to include in Section 22A the income from state bonds that have been declared exempt by the Massachusetts Legislature. The Massachusetts Legislature has created several independent Authorities by special enabling acts. The Legislature induced insurance companies and other investors to purchase bonds of

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[1] The statute also includes exceptions for estate and inheritance taxes which are not relevant here.

these Authorities by providing in the enabling acts that their bonds would be exempt from Massachusetts taxation. In 1958 the State Tax Commission of Massachusetts ruled that Authority bond interest is exempt from the corporate excise tax by virtue of the enabling acts. Petitioners maintain that the Contracts Clause bars the Commissioner of Revenue from now including such Authority bond interest in income taxable under Section 22A. Accordingly, Section 22A should be applied so as to exclude Authority bond interest. When so applied Section 22A becomes discriminatory in violation of 31 U.S.C. § 742, since it taxes federal obligations but not state obligations, and therefore, either in its entirety or as applied to interest on United States Government bonds, should be struck down.

This Petition concerns tax years 1971 through 1977. During these years, Petitioners received income from United States Government bonds and from bonds of the Massachusetts Bay Transportation Authority ("MBTA"), the University of Massachusetts Building Authority ("UMBA") and the Massachusetts Housing Finance Agency ("MHFA"). Pursuant to Section 22A, Petitioners paid for each of these years a Massachusetts tax which included one percent of the income from each of these federal and state bonds. Petitioners subsequently filed claims for refunds of the entire tax paid under Section 22A, which the Commissioner of Revenue denied. Petitioners challenged this denial before the Appellate Tax Board, and that body upheld the Commissioner's action. The Supreme Judicial Court of Massachusetts affirmed. Petitioners stated both of the questions presented here in their written claims for refunds, in their petitions to the Appellate Tax Board, and in their appeal to the Supreme Judicial Court.

REASONS FOR GRANTING THE WRIT

This case presents in clear form constitutional issues of great current significance. Taxation of bond interest is

a major source of revenue for many states. In recent years many states have strained to raise revenues by taxing United States Government bonds and state bonds that had previously been exempt. These measures substantially increase the cost of federal funds to the United States Government,[2] and raise recurring and important issues of federal supremacy and the impairment of contracts. This Petition presents a good opportunity for the Court to clarify conflicting decisions, to correct states which have taken advantage of this Court's relative inattention, and to provide guidance to both the states and taxpayers as to how interest on federal and state bonds may and may not be taxed.

Under 31 U.S.C. § 742, the interest on federal bonds is exempt from state taxes except in the case of "nondiscriminatory or other non-property taxes in lieu thereof." The Supreme Judicial Court held that Section 22A is such a permitted tax. A5. The Supreme Judicial Court baldly and incorrectly asserted that this Court's decision in *Northwestern Mutual Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), is no longer sound law. A6-7. This Court has never overruled or impaired *Northwestern Mutual*, however, and *Northwestern Mutual* has been cited as recently as 1981 by the court of last resort in another state. *See Continental Bank v. Arizona Department of Revenue*, 638 P.2d 228, 234 (Ariz. 1981).

The Supreme Judicial Court also held that Authority bond interest may be included in the measure of income subject to tax under Section 22A, despite the explicit statutory provision for tax exemption contained in the enabling acts of the Authorities. The Supreme Judicial Court held that this exemption applies only to a direct tax

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[2] In 1988 the net interest paid by the United States Treasury on public debt was $151.711 billion. Federal Reserve Bulletin, June 1989, at A29. If the Treasury were forced to raise the interest rate by 1.01% in order to counterbalance a one percent tax imposed by state statutes such as Section 22A, the cost to the United States would be $1.532 billion per year.

on income, and not to an excise tax. A8-9. This judicial sleight of hand is impermissible under *Macallen Company v. Massachusetts*, 279 U.S. 620 (1929), and is contrary to decisions by courts of last resort in other states.

I. Whether A State Gross Income Tax May Be Sustained As A "Franchise Tax" – Notwithstanding This Court's Clear Opinion To The Contrary In Northwestern Mutual – Is An Important Question Of Federal Law, Because The Meaning Of This Statutory Term Has Confused State Courts and Requires Clarification.

This case presents the important question, which has given rise to confusion in the state courts, whether a state may evade the constitutional and statutory prohibitions against the taxation of income from federal bonds merely by designating its exaction as a "franchise tax." Section 22A purports to include interest from federal bonds in the measure of taxable gross investment income. It may not validly do so, however, unless it is a "franchise tax" permitted under 31 U.S.C. § 742. Despite its label, Section 22A is not a franchise tax, since it imposes a direct tax on a class of income, and since it does not fairly measure the value of the franchise.

This case presents in unusually clear form the important question of what Congress meant when it used the term "franchise tax" in 31 U.S.C. § 742. This Court treated 31 U.S.C. § 742 in three opinions approximately five years ago. *See First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985); *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983); *Memphis Bank & Trust Company v. Garner*, 459 U.S. 392 (1983). Those opinions have given rise to a flurry of litigation in state courts challenging various state taxes which include federal bonds. *First National Bank of Atlanta, American Bank* and *Memphis Bank* left open the question of what constitutes a "franchise tax" permitted by the federal statute. *See* Blasi and Joyce, *The Franchise Tax Exception To The Federal Exemption Statute*, 102 Banking L.J. 462 (1985) ("the

Supreme Court has failed to provide the drafters of state laws with a workable definition of a franchise tax").

A. That the interest on federal bonds may not be taxed is a fundamental principle of federal constitutional, statutory, and decisional law that deserves this Court's attention and protection. Review of this case is needed to achieve the legislative purposes of the 1959 amendment to 31 U.S.C. Section 742.

Ever since *McCulloch v. Maryland*, 4 Wheat 316 (1819), this Court has held that the states may not burden the federal government's exercise of its powers. Consistent with this core principle of American federalism, the states may not impose a tax on United States Government bonds, because this would burden the federal government's exercise of its power to borrow money. *See Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829). Congress codified this fundamental principle of federal immunity in 1862, providing that "obligations of the United States . . . shall be exempt from taxation by or under state or municipal or local authority." Act of February 25, 1862, Chapter 33, Section 2, 12 Stat. 346. The governing statute, 31 U.S.C. § 742, read in that form until 1959.

Over the course of the century after the statute was enacted, there developed a judicial exception to this statutory prohibition. The courts held that interest on federal bonds could be included in the measure of a permissible franchise or privilege tax, so long as the tax was imposed on the privilege of doing business, and not on the bond income itself. This judicial exception rested on a distinction between a tax "on" bond income and a tax "measured by" bond income, a distinction recently characterized by this Court as "formalistic". *American Bank*, 463 U.S. at 862, 866-67.

This formalistic distinction created a severe and obvious risk that the fundamental immunity principle would be evaded. Congress amended the statute in 1959

to eliminate "formalistic" distinctions. *American Bank*, 463 U.S. at 866-67.[3] The amendment was prompted by a tax imposed by Idaho. Idaho included federal bond interest in income subject to the state's personal income tax, maintaining that the tax was not a direct tax "on" income, but rather a tax on individuals which was merely "measured by" income. Congress responded to the Idaho tax by adding the second sentence of the current statute:

> This exemption extends to *every form* of taxation that would require that either the obligations *or the interest* thereon, or both, be considered, *directly or indirectly*, in the computation of the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes (emphasis added).

Congress acted to protect the U.S. Treasury from any state taxes, however labelled, that increase the cost of issuing bonds. *See State Taxation of Bank Shares: American Bank & Trust Co. v. Dallas County*, 1984 Annual Review of Banking Law 391, 398. Congress made clear that Idaho may not include United States Government bond interest in Idaho's personal income tax simply by labelling it a tax on individuals. Similarly, Massachusetts cannot include United States Government bond interest in Section 22A simply by labelling it a tax on the privilege of doing business. Section 22A cannot include federal bond interest unless it is truly a legitimate franchise tax.[4]

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[3] The statute was amended again in 1982 by omitting surplus words, but this amendment was not intended to make any substantive change. *American Bank*, 463 U.S. at 859 n.1.

[4] Recent decisions of this Court treating other branches of the doctrine of intergovernmental immunity suggest that the doctrine focuses almost entirely on discrimination. *See Davis v. Michigan Department of Treasury*, 103 L. Ed. 2d 891 (1989); *South Carolina v. Baker*, 108 S. Ct. 1355 (1988). *But see Society For Savings v. Bowers*, 349 U.S. 143, 144 (1955). Section 742 as

(Continued on following page)

The language of the current statute contains a paradox, however, which badly needs judicial clarification. The judicially created category of "franchise taxes," as understood prior to 1959, rests on the formalistic distinction between a tax "on" income and a tax "measured by" income. As understood prior to 1959, an income tax was a tax imposed "on" income, whereas a franchise tax was a tax imposed "on" the privilege of doing business and merely "measured by" income. In 1959 Congress acted to eliminate this distinction (at least with respect to taxes on individuals), and yet the statutory exemption for franchise taxes may rest in part on the same distinction. *See* Blasi and Joyce, *Bank Shares Taxation, Another Trap For the Unwary Draftsman*, 51 Tenn. L. Rev. 445, 446-47 (1984). Petitioners' case exposes this paradox and presents an excellent opportunity for this Court to eliminate the confusion.

This Court's most important response to the risk created by formalistic distinctions in this area came in *Northwestern Mutual Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), which ruled that a state may *not* include United States Government bonds in the measure of a gross income tax such as Section 22A. It is well established that the 1959 amendment to 31 U.S.C. § 742 was intended to codify existing case law and to broaden the prohibition contained in the statute, not to narrow it. *First National Bank of Atlanta*, 470 U.S. at 594; *American Bank*, 463 U.S. at 863-65. Accordingly, the tax that was struck down in *Northwestern Mutual* is still forbidden today.

In *Northwestern Mutual* Wisconsin imposed on insurance companies an annual license fee of three percent of

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enacted in 1959 prevents more than discrimination, however. In order to tax federal bonds a state tax must not only be nondiscriminatory, it must also be a franchise tax. It is well established that Congress has the power to "enlarge it [immunity] beyond the point where, Congress being silent, the Court would set its limits." *Helvering v. Gerhardt*, 304 U.S. 405, 411-12 n.1 (1938).

gross non-premium income. Wisconsin argued that this tax was imposed on the privilege of doing business, not on the income itself, and could therefore include federal bond interest. This Court squarely rejected Wisconsin's argument.

> The fundamental question . . . is whether by the true construction of the statute the assessment must be regarded as a tax upon property or one on privileges or franchise of the corporation. . . .
>
> The distinction between an imposition the amount of which depends upon dividends or net receipts and one measured by gross returns is clear. *U.S. Glue Co. v. Town of Oak Creek,* 247 U.S. 321, 328, and earlier opinions there cited. . . .
>
> Here the statute undertook to impose a charge of 3 percent upon every dollar of interest received by the Company from United States bonds. So much, in any event, the State took from these very receipts. This amounts, we think, to an imposition upon the bonds themselves and goes beyond the power of the State.

275 U.S. at 140-41. *Northwestern Mutual* squarely held that a tax measured by gross income is not a franchise tax. It expressly distinguished taxes measured by net income. *See Orange Mutual Life Co. v. State Tax Commission,* 283 P.2d 187, 193 (Idaho 1955) (affirming distinction between tax measured by gross income and tax measured by net income).

Despite the contrary suggestions of the Supreme Judicial Court, the rationale of *Northwestern Mutual* remains sound. If the integrity of the statutory and constitutional tax immunities is to be upheld, protective lines must be drawn. The line drawn by *Northwestern Mutual* – and rejected by the Massachusetts court in this case – is plain. The three percent gross income tax imposed by Wisconsin, like the gross income tax imposed by Section 22A, made no attempt to measure fairly the value of the privilege of doing business. It did not take into account

any factor other than the receipts themselves. The inference was therefore unmistakable, especially in light of the constitutional imperative to protect the integrity of federal tax immunity, that a gross income tax levied on the income from United States bonds is in substance, purpose and effect a tax on the bonds themselves. Whether or not a franchise tax might reasonably be levied on *net* income, a *gross* income tax, whatever label the state might attempt to apply, must be invalidated as an unlawful burden on the federal power to borrow money.[5]

The Supreme Judicial Court of Massachusetts erroneously pronounced that *Northwestern Mutual* has been overruled. A6-7, *citing, Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492 (1956). In fact, however, *Werner Machine Co.* concerned a tax measured by *net worth*, one of the traditional measures of a franchise tax. This Court has never endorsed a franchise tax measured by *gross* income, and this Court has never questioned, let alone overruled, *Northwestern Mutual. Cf. Society for Savings v. Bowers*, 349 U.S. 143 (1955) (striking down property tax); *Tradesmens National Bank of Oklahoma v. Oklahoma Tax Comm'r*, 309 U.S. 560 (1940) (upholding tax measured by *net* income); *Educations Films Corp. v. Ward*, 282 U.S. 379 (1931) (upholding tax measured by *net* income); *Des Moines National Bank v. Fairweather*, 263 U.S. 103 (1923)

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[5] As the Court stated in *U.S. Glue Co. v. Town of Oak Creek*, 247 U.S. 321 (1918): "The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction. . . . A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss. . . . A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. . . ." 247 U.S. at 328-29.

(upholding tax measured solely by capital stock); *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911) (upholding tax measured by *net* income); *Home Ins. Co. v. New York*, 134 U.S. 594 (1890) (upholding tax measured by capital stock and dividends); *Provident Institution v. Massachusetts*, 73 U.S. (6 Wall.) (1868) (upholding tax measured by value of assets).

The court of last resort in another state has cited *Northwestern Mutual* as recently as 1981. *See Continental Bank v. Arizona Department of Revenue*, 638 P.2d 228, 234 (Ariz. 1981). The courts of last resort in two other states have suggested that *Northwestern Mutual* has been overruled. *See Midland Financial Corp. v. Wisconsin Department of Revenue*, 341 N.W.2d 397, 405 & n.10 (Wis. 1983) (suggesting that *Northwestern Mutual* was overruled by the amendment of 31 U.S.C. § 742 in 1959); *Anderson-Cherne v. Commissioner of Taxation*, 226 N.W.2d 611, 614 (Minn. 1975) (suggesting that *Northwestern Mutual* was overruled by *Werner Machine Co.*). Taxpayers, state legislatures and state tax departments would benefit from a clarification of the status of *Northwestern Mutual*, which only this Court can provide.

Not only did this Court rule in *Northwestern Mutual* that a gross income tax is not a franchise tax, but in fact a gross income tax does not fit the accepted meaning of the term. In ordinary usage the term "franchise tax" means a tax which measures the *value* of the privilege of doing business in corporate form. A franchise tax is:

> A tax on the franchise of a corporation, that is, on the right and privilege of carrying on business in the character of a corporation, for the purposes for which it was created, and in the conditions which surround it.

Black's Law Dictionary 593 (5th ed. 1979); *Home Ins. Co. v. New York*, 134 U.S. 594 (1890). This Court described franchise taxes further in *American Bank*. As the Court observed:

> [F]ranchise and estate and inheritance taxes customarily assess the franchise or the demise at

> the value of the assets of the business or at the value of the property inherited. *See, e.g., Werner Machine Co. v. Director of Taxation*, 350 U.S., at 492 (franchise tax measured by "net worth"); . . . *Home Ins. Co. v. New York*, 134 U.S., at 599 (franchise tax measured by "capital stock and dividends").

463 U.S. at 863. Section 22A does not employ any of the accepted methods. Section 22A does not assess an insurance company's franchise at the value of its assets, nor does Section 22A measure the insurance company's net worth or the value of its capital stock. Section 22A imposes a tax measured solely by gross income. But gross income, calculated without any deductions for debts or expenses, cannot measure the *value* of a franchise. In fact, a Massachusetts insurance company could be losing money or could be insolvent, and yet it would still be assessed a tax under Section 22A. Thus Section 22A does not fairly measure the value of the franchise, and Section 22A does not fall within any accepted meaning of the term "franchise tax."

B. Review of this case is needed to assure coherence and consistency in the application of 31 U.S.C. Section 742.

In upholding Section 22A as a permissible franchise tax, the Massachusetts Supreme Judicial Court refused to acknowledge the controlling authority of this Court's decision in *Northwestern Mutual*. Moreover, it so construed the applicable federal statute as to create a loophole of gargantuan proportions. According to its reasoning, a state's selection of the label "franchise tax" would exert a talismanic force in defeating the tax immunities conferred by the federal constitution and by federal statute. If the "franchise tax" exception is to be an analytical category rather than an endlessly expansive loophole, Section 22A must be invalidated on grounds of its incompatibility with the Constitution and laws of the United States.

The Supreme Judicial Court's refusal to be bound by this Court's decision in *Northwestern Mutual* would itself merit review by this Court. The necessity of review is made even more urgent by a recurring pattern of confusion regarding the construction of 31 U.S.C. § 742. The pattern is one in which courts, including this Court, have sometimes exalted form over substance: they have upheld taxes that diminish the value of federal bonds (and thus increase the cost to the United States Treasury) so long as, formalistically, the taxes were denominated as franchise taxes and the amount of the tax was said to be "measured by", rather than "levied on", income from federal bonds.

The formalistic approach to constitutional tax questions, from which the decision below takes its rationale, is one that this Court has recently renounced. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), laid down the clear and sensible rule that real economic effects, not formalistic labels, should govern questions of the states' constitutional authority to impose a tax. *Complete Auto Transit* rejected the notion that a state tax may be valid simply because the state says it is imposed for the privilege of doing business. As the Court stated, "[t]here is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." *Complete Auto Transit*, 430 U.S. at 288.

This case presents a much needed opportunity to clarify not only the status of *Northwestern Mutual* as applied to a "franchise tax" measured by gross income, but also the status of *Complete Auto Transit* and *American Bank* as applied to a "franchise tax" measured by income of any kind.[6] *American Bank* extends the focus on real

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[6] The tax at issue in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), was measured by net earnings. The Court expressly reserved the question whether this tax could be characterized as a franchise tax. *Id.* at 396 n.6. The question is an important and urgent one.

economic effects to questions arising under 31 U.S.C. § 742. As *American Bank* recognized, Congress amended the controlling statute in 1959 in order to eliminate formalistic distinctions. Thus it appears – but apparently has not yet been stated clearly enough by this Court to make the state courts understand that they are bound – that there is no longer any constitutional distinction between a tax "on" bond income and a tax "measured by" bond income. *See American Bank & Trust Co. v. Dallas County: The Quiet Passing of the Separate Incidence Rule*, 41 Tax Lawyer 831 (1988). As this Court held in *American Bank*, a tax purportedly levied on bank shares was "barred, regardless of its *form* if federal obligations must be considered, either directly or indirectly, in computing the tax."

Certain of the courts of last resort in the various states have ignored the teaching of *Complete Auto Transit* and *American Bank* and have used outmoded tax labelling to preserve (but never to strike down) challenged state taxes. *See National Bank of Alaska v. State of Alaska*, 769 P.2d 990 (Alaska 1989) (business license tax measured by percentage of net income is a franchise tax); *Centerre Bank of Crane v. Director of Revenue*, 744 S.W.2d 754 (Mo. 1988) (upholding inclusion of federal bond interest under tax measured by net income); *Savings League of Wisconsin, Ltd. v. Wisconsin Dept. of Revenue*, 416 N.W.2d 650 (1987), *appeal dismissed*, ___ U.S. ___, 109 S. Ct. 37 (1988) (United States Government bonds may be included under Wisconsin's corporate franchise tax, even though this tax is substantively identical to Wisconsin's corporate income tax); *State Department of Assessments and Taxation v. Maryland National Bank*, 531 A.2d 294 (Md. 1987), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 2812 (1988); *Department of Revenue v. First Union National Bank of Florida*, 513 So.2d 114 (Fla. 1987), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 1253 (1988); *Garfield Trust Co. v. Director, Division of Taxation*, 508 A.2d 1104 (N.J. 1986), *appeal dismissed*, 479 U.S.

925 (1986); *Reuben L. Anderson-Cherne, Inc. v. Commissioner of Taxation*, 226 N.W.2d 611 (Minn. 1975), *appeal dismissed*, 423 U.S. 886 (1975) (franchise tax may use net income as a yardstick, so long as the tax is imposed only where the earning of income and the exercise of privilege coincide). These decisions assert that any tax which purports by its label to be imposed on the privilege of doing business constitutes a "franchise tax" within the meaning of 32 U.S.C. § 742. They clearly reduce the statutory term to a mere label.[7]

Other state courts have examined the substance and effect of a state tax in order to determine whether the income of tax-exempt bonds may be included. *See First Federal Savings & Loan Ass'n of Philadelphia v. Commonwealth*, 528 A.2d 942 (Pa. 1987) (mutual thrift institution tax was in substance and effect a tax on income, despite label designating it as a tax for the privilege of doing business); *Dale National Bank v. Commissioner*, 465 A.2d 965 (Pa. 1983) (bank shares tax was in substance and effect a property tax, despite the Legislature's attempt to re-label it as a tax on the privilege of doing business); *Federal Prod. Corp. v. Norberg*, 429 A.2d 447 (R.I. 1981) (proceeds of sale of U.S. Government bonds could not be included in the measure of net income subject to business corporation tax). *See also Cambridge State Bank v. Roemer* (District Court, Ramsey County Minnesota) (May 20,

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[7] The fact that the Supreme Court dismissed the taxpayer's appeal from the decisions in four of these net income cases does not mean that this Court approved the reasoning of these decisions. *See Mandel v. Bradley*, 432 U.S. 173 (1977) (summary affirmances affirm only the judgments of lower courts and not their reasoning). Furthermore this Court denied *certiorari* in *First Federal Savings and Loan Assoc. v. Department of Revenue*, 654 P.2d 496 (Mont. 1982), *cert. denied*, 462 U.S. 1144 (1983), which struck down a state tax despite its label. *See infra*, text accompanying footnote 8.

1987) (Minnesota bank tax was a direct tax on income from U.S. Government bonds); *C.C. Collings & Co., Inc. v. Commonwealth*, 488 A.2d 1187 (Cmwlth. Ct. Pa. 1984), *aff'd per curiam sub nom. Commonwealth Securities and Investments, Inc. v. Commonwealth*, 514 A.2d 1373 (Pa. 1986) (corporate net income tax was in substance and effect a tax on income, despite being labelled as tax for the privilege of doing business). These courts focus on the actual economic effect of the tax, as Congress did in 1959 and as this Court instructed in *Complete Auto Transit* and *American Bank*. As these courts correctly reason, "in the last analysis the nature of the tax depends not upon its label but upon . . . its practical operation and effect." *First Federal Savings & Loan Ass'n of Philadelphia v. Commonwealth*, 528 A.2d 942, 945 (Pa. 1987). In other words, *"the issue is not the rationale for exacting the payment, but the subject of the exaction." Id.* at 946 (emphasis in the original).

The court of last resort in one state moved from one side of the conflict to the other in a two-year span. The Supreme Court of Montana ruled in *First Federal Savings & Loan Ass'n v. Department of Revenue*, 654 P.2d 496 (Mont. 1982), *cert. denied*, 462 U.S. 1144 (1983), that Montana's bank tax was an impermissible direct tax on income from federal bonds. While the Montana court subsequently reversed itself in *Schwinden v. Burlington Northern, Inc.*, 691 P.2d 1351 (Mont. 1984), it is clear that the later decision was the result of a desire to maintain revenues.[8] Many state courts have understandably sympathized with this desire, but it is not a permissible basis for abridging the immunity afforded federal bonds by the Constitution, Congress and this Court. The Montana court's easy and political change of labels illustrates the potential for confusion and abuse in this area.

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[8] The *Schwinden* opinion emphasizes the fiscal emergency created by *First Federal*. Further, the decision to reexamine *First Federal* was suggested by the Montana Bankers Association appearing as an *amicus curiae*, not by any of the parties.

Section 742's central prohibition against "direct or indirect" taxes would be rendered a nullity if the states were allowed to include the income from federal bonds in any tax scheme that they denominated as "franchise taxes." Yet that is precisely what the Massachusetts court allowed in this case. The Supreme Judicial Court upheld Section 22A because it characterized Section 22A as a tax not imposed "on" bond income, but merely "measured by" bond income. A6-7. This labelling is contrary to the teaching of *Complete Auto Transit* and *American Bank*, and it flatly conflicts with the approach taken by Pennsylvania in *First Federal Savings & Loan Ass'n of Philadelphia v. Commonwealth*, 528 A.2d 942 (Pa. 1987), *supra*. If Congress did indeed eliminate formalistic distinctions when it amended 31 U.S.C. § 742 in 1959, then the decision of the Supreme Judicial Court cannot stand.

To achieve coherence and enforceability in the administration of 31 U.S.C. § 742, this Court must give guidance to the state courts on the pressing practical question of what types of exactions do and do not qualify as "franchise taxes." In response to this question, the formalistic answer of the Supreme Judicial Court, which refused to go beyond labels to examine real economic effect, was arbitrary and, from the federal perspective, dysfunctional and impermissible. As shown above, gross income cannot measure the value of a franchise. Thus if Section 22A is a "franchise tax" within the meaning of 31 U.S.C. § 742, then any non-property tax is a "franchise" tax, reducing the term "franchise" tax to a mere label of convenience. This labelling threatens to create a loophole in Section 742's tax-exemption scheme at least as large as the one that the Court closed in *American Bank*. Indeed, it creates a loophole that *American Bank* – closing another claimed loophole in the same statute – has given state legislatures new incentive to exploit. The question presented by this case is therefore of great and increasing practical importance.

The steady stream of cases cited above also demonstrates that the meaning of the term "franchise tax"

contained in 31 U.S.C. § 742 is an important issue to taxpayers, legislatures and tax commissioners across the nation. Billions of tax dollars are at issue in these cases – a substantial portion of the tax revenues of the affected states. The courts of many states have increasingly – and not surprisingly – tended to rule in favor of upholding tax revenues.[9] This Court is the only forum available to give full weight to the important federal interests involved in the taxation of United States Government bonds. Thus this Court ought to reach the merits of at least one of the cases in this area. The present case is a particularly appropriate one for review because of its direct presentation of the critical issues, and because of the cavalier way in which the Supreme Judicial Court set aside this Court's decision in *Northwestern Mutual.*

II. Whether A State's Commissioner Of Revenue May Without Constitutional Amendment, Legislation Or Even Regulation Disregard The Ruling Of His Predecessor And Legislation Which Exempts The Bonds Of Independent Authorities Is An Important Question Under The Contracts Clause.

This case also presents an important issue of the impairment of contracts, because the Massachusetts Commissioner of Revenue has attempted to tax the bonds of certain

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[9] Even in several cases where a state court has struck down a tax as unconstitutional under *Memphis Bank* or *American Bank,* the state court nonetheless gave its decision only prospective effect. *See First of McAlester Corporation v. Oklahoma Tax Commission,* 709 P.2d 1026 (Okla. 1985); *First Bank of Deer Park v. Deer Park Independent School District,* 770 S.W.2d 849 (Texas Ct. of Appeals 1989); *Schreiner Bank v. Kerrville Independent School District,* 683 S.W.2d 466 (Texas Ct. of Appeals 1984). *See also McKesson Corp. v. Florida,* 524 So.2d 1000 (Fla. 1988), *cert. granted,* ___ U.S. ___, 109 S. Ct. 389 (Nov. 14, 1988), *restored for reargument,* ___ U. S. ___, 109 S. Ct. 3238 (Jul. 3, 1989); *American Trucking Ass'n, Inc. v. Arkansas Highway and Transp. Dept.,* 746 S.W.2d 377 (Ark. 1988), *cert. granted,* ___ U. S. ___, 109 S.

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independent Authorities, which the Legislature and the State Tax Commission have declared to be exempt. Both before and especially since this Court's decision in *Memphis Bank & Trust Company v. Garner*, 459 U.S. 392 (1983), tax commissioners in many states have attempted to raise tax revenues from tax-exempt state bonds,[10] and taxpayers have challenged these attempts. *See, e.g., Centerre Bank of Crane v. Director of Revenue*, 744 S.W.2d 754 (Mo. 1988) (bonds of Missouri authorities); *First Federal Savings & Loan Ass'n of Philadelphia v. Commonwealth*, 528 A.2d 942 (Pa. 1987) (obligations issued by Pennsylvania, its agencies and political subdivisions); *Department of Revenue v. First Union National Bank of Florida*, 513 So.2d 114 (Fla. 1987), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 1253 (1988) (Florida water and sewer bonds and Pasco County Expressway bonds); *Garfield Trust Co. v. Director, Division of Taxation*, 508 A.2d 1104 (N.J. 1986), *appeal dismissed*, 479 U.S. 925 (1986) (state, local and authority bonds of New Jersey); *Cambridge State Bank, et al. v. Roemer* (District Court, Ramsey County Minnesota) (May 20, 1987) (bonds of Minnesota agencies); *C.C. Collings & Co., Inc. v. Commonwealth*, 488 A.2d 1187 (Cmwlth. Ct. Pa. 1985), *aff'd per curiam sub nom. Commonwealth Securities and Investments, Inc. v. Commonwealth*, 514 A.2d 1373 (Pa. 1986) (obligations of Pennsylvania, its agencies and political subdivisions).[11] It is an important question whether – and to what extent – the Contracts Clause prohibits such taxation.

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Ct. 389 (Nov. 14, 1988), *restored for reargument*, ___ U.S. ___, 109 S. Ct. 3238 (Jul. 3, 1989); *James B. Beam Distilling v. Georgia* (Supreme Ct. of Georgia No. 46642) (July 14, 1989) (available on Westlaw); *National Can Corp. v. Department of Revenue*, 749 P.2d 1286 (Wash. 1988), *appeal dismissed*, ___ U.S. ___, 108 S. Ct. 2030 (1988).

[10] Under *Memphis Bank*, tax commissioners must include all state bonds in the measure of any franchise tax, or else they will lose the ability to tax federal bonds.

[11] Four of these cases concern bonds of independent authorities. Thus it is clear that the second issue raised by this Petition has immediate significance for many states in addition to Massachusetts.

On two occasions, in cases more than a century old but never overruled or declared incorrect, this Court held that a legislature can enact a contractually binding tax exemption, and that when it does so, a refusal to honor that exemption offends the Contracts Clause. *See Murray v. Charleston*, 96 U.S. 432, 444 (1878); *University v. People*, 99 U.S. 309 (1879). The Court reaffirmed this position in *Macallen Company v. Massachusetts*, 279 U.S. 620 (1929), which found that the Massachusetts Legislature's attempt to tax certain county bonds "impairs the obligation of the statutory contract of the state by which such bonds were made exempt from state taxation." 279 U.S. at 634 (emphasis added). Although the scope of the *Macallen* holding was limited two years later in *Educational Films Corporation v. Ward*, 282 U.S. 379 (1931), its core prohibition remained intact. As *Educational Films* interpreted *Macallen*, *Macallen* rested on a finding that the Massachusetts Legislature had amended the taxing statute with the specific intent to reach bond income it had earlier declared exempt. *See Educational Films*, 282 U.S. at 392.

The application of Section 22A to the tax-exempt bonds of state Authorities fits the paradigm of behavior forbidden by the Contracts Clause as construed in this Court's cases. During the tax periods in question, Petitioners held bonds of three Massachusetts authorities: the MBTA, the UMBA and the MHFA. The enabling Acts of these three Authorities expressly exempt Authority bond interest from Massachusetts taxation:

> Bonds and notes issued by the authority, their transfer and the income therefrom, including any profit made on the sale thereof, shall at all times be free from taxation within the commonwealth.

Mass. G.L. c. 161A, § 18; St. 1964, c. 563, § 18 (MBTA).

> [T]he notes and bonds issued under the provisions of this act, their transfer and the income therefrom, including any profit made on the sale thereof, shall at all times be free from taxation within the commonwealth.

Mass. G.L. c. 75 App., § 1-15; St. 1960, c. 773, § 15 (UMBA).

> The Commonwealth covenants with the Purchasers and all subsequent holders and transferees of the notes and bonds issued by the MHFA, in consideration of the acceptance of any payment for the notes and bonds, that the notes and bonds of the MHFA issued pursuant to this act and the income therefrom shall at all times be free from taxation.

Mass. G.L. c. 23A App., § 1-12; St. 1966, c. 708, § 12 (MHFA).

The three Enabling Acts further demonstrate that in each case the Legislature specifically intended that the tax exemption should apply when the bonds are held by insurance companies. All three statutes provide that bonds of the Authority are securities in which insurance companies may invest. *See* c. 161A, § 25 (MBTA); c. 75 App., § 1-16 (UMBA); and c. 23A App., § 1-13 (MHFA). Moreover in the latter two Enabling Acts the provision making the bonds eligible for investment follows immediately after the provision for tax exemption. Thus the Massachusetts Legislature induced insurance companies and others to buy Authority bonds (and effectively lowered the interest rate the Authorities had to pay on those bonds) by providing that Authority bonds would be exempt from taxation in Massachusetts.

In 1958 a ruling of the Massachusetts State Tax Commission affirmed that Authority bond interest is tax-exempt. Corporation Excise Tax Ruling 1958-7 ("Ruling 1958-7") was signed by all three members of the State Tax Commission, including the then Commissioner of Corporations and Taxation.[12] Ruling 1958-7 specifically dealt

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[12] Until the reorganization of the Department of Revenue in 1978, which eliminated the State Tax Commission and placed a Commissioner in charge of the Department of

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with the then corporate excise tax. (Section 22A did not then exist.) However, its holding rested on the language of the enabling acts, not the language of the tax statute, and thus clearly is applicable to Section 22A. In pertinent part, Ruling 1958-7 provides as follows:

> "Net income" is defined in Chapter 63, section 30(5) as
>
> "the gross income from all sources, without exclusion, for the taxable year, less the deductions, other than losses sustained by the corporation in other fiscal or calendar years and other than dividends, allowable by the federal revenue act applicable for said calendar year. . . ."
>
> 2. Interest on bonds of certain instrumentalities of Massachusetts *where the statute creating the instrumentality exempts interest on its bonds from taxation*, does not form a part of "gross income" under section 30(5) of Chapter 63. Examples of such instrumentalities are Massachusetts Turnpike Authority, Mystic River Bridge Authority, New Bedford, Woods Hole, Martha's Vineyard and Nantucket Steamship Authority, Massachusetts Port Authority, Mount Greylock Tramway Authority, University of Massachusetts.

Ruling 1958-7, [1 Mass.] St. Tax Rep. ¶ 10-320.40 (Aug. 12, 1958) (emphasis supplied).

The enabling acts for the Massachusetts Turnpike Authority and the Massachusetts Port Authority, which are cited as examples in Ruling 1958-7, contain tax-exemption language which is virtually identical to the enabling acts at issue in this case. *See* G.L. c. 81 App., § 1-13 (Massachusetts Turnpike Authority); G.L. c. 91

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Revenue, the State Tax Commission was charged with interpreting tax statutes on behalf of the Commonwealth. *See* St. 1953, c. 654; G.L. c. 14, §§ 3-4 (1953) (*superseded by* G.L. c. 14, §§ 3, 6 (1978)). The Chairman of the State Tax Commission was the approximate equivalent of today's Commissioner of Revenue.

App., § 1-17 (Massachusetts Port Authority). Thus there can be no doubt that Ruling 1958-7 would also include the later-created MBTA, UMBA and MHFA in the list of instrumentalities which are exempt by statute. The ruling specifically excluded from gross income interest on bonds of such Authorities.

Ruling 1958-7 has never been revoked. It is still outstanding. The Commissioner of Revenue did not issue any public statement contrary to Ruling 1958-7 until the mid-1980's (after *Memphis Bank*), when he issued Letter Ruling 84-61 and Technical Information Release 85-6. Neither of these documents was a regulation promulgated in accordance with Mass. G.L. c. 30A, the state's equivalent of the Administrative Procedure Act. Consequently, these measures were not sufficient to revoke a longstanding ruling of the State Tax Commission. Moreover they were issued long after Petitioners had acquired the Authority bonds at issue here, and had paid the taxes in question.

In conjunction, the Authority enabling acts and the 1958 ruling – both intended to induce the reliance of bond purchasers – create a contract between bondholders and the state that is binding on the state under the Contracts Clause. Acting unilaterally, the Commissioner of Revenue has abandoned Ruling 1958-7 with the specific intent to tax Authority bond interest that the Legislature earlier declared exempt. This is impermissible under this Court's precedents. *Macallen* held that alteration of the tax structure in order to reach bond income that was earlier declared exempt violates the Contracts Clause.

Although the Supreme Judicial Court held that Section 22A does not violate any covenant actually created by Massachusetts law, it is well settled that whether a contract exists for Contracts Clause purposes is a question that is subject to review by this Court. *See, e.g., Indiana ex. rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938) ("In order that the [Contracts Clause] not become a dead letter, we are bound to decide for ourselves whether a contract was made, what are its terms and conditions,

and whether the State has, by later legislation, impaired its terms and conditions.") This Court should grant the writ to clarify the continuing validity of its decisions protecting contracts created by state legislation that promises tax immunity.

Where a state legislature acts to impair a contract made with the state itself, the state must show that its action serves a public necessity and that there are no available alternatives; otherwise, that action violates the Contracts Clause. *Allied Structural Steel Company v. Spannaus*, 438 U.S. 234 (1978); *U.S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977); *City of El Paso v. Simmons*, 379 U.S. 497 (1965). The Commissioner of Revenue's attempt to tax Authority bonds here impairs a covenant made by the Massachusetts Legislature. There is no public necessity for Massachusetts to tax Authority bond interest, and thus the Commissioner's action violates the Contracts Clause. If Massachusetts needs the money it can raise the money by other and proper means.

Furthermore, there is no indication that the Massachusetts Legislature intended to subject Authority bonds to tax when it enacted Section 22A. There is no evidence that the Legislature considered this issue. If it did, the most likely hypothesis is that, itself relying on Ruling 1958-7, it thought that Section 22A would not reach Authority bond interest. Thus only the Commissioner of Revenue has acted to tax Authority bond interest, reversing without authority the position taken by his predecessor in Ruling 1958-7. Where only the Commissioner of Revenue, and not the Legislature, takes action that impairs contractual obligations, such action cannot possibly pass muster under the Contracts Clause. *Cf. U.S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977).

Once it is established that the interest on bonds of Massachusetts Authorities is exempt under Section 22A by virtue of the Contracts Clause, it necessarily follows that Section 22A is discriminatory against federal obligations within the meaning of 31 U.S.C. § 742. *See Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). As a result,

Section 22A cannot reach the interest on United States Government obligations. *Id.*

Because a state tax must include the interest on all state bonds in order to reach interest on federal bonds, there will be a continuing stream of attempts to tax state bond interest that was made exempt by state statute, and therefore of cases challenging those attempts. These challenges have great significance for state budgets, and this Petition presents an excellent test case and an opportunity for this Court. This case fairly and appropriately tests whether it is a violation of the Contracts Clause to include interest of tax-exempt state bonds in the measure of a so-called franchise tax; whether it matters if the tax is imposed by administrative action without benefit of statute; and whether the states are free, as some of them think they are, to ignore or flout this Court's *Complete Auto Transit* decision by defending the constitutionality of such taxation through the manipulation of labels.

CONCLUSION

The two questions raised by this Petition arise (and will continue to arise) frequently in the courts of states across the nation. Taxes on bond income are an important source of revenue for many states and state courts have gone very far to uphold those taxes. The applicable legal doctrine is marked by confusion and a degree of disingenuousness amounting to willful evasion of rules established by Congress and this Court. Petitioners' case is deserving of certiorari because (i) it presents a clear test of the meaning and limits of the statutory term "franchise tax" in light of *Northwestern Mutual Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), and *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); and (ii) it presents a clear test of the Contracts Clause in light of the enabling acts of the Massachusetts Authorities, which are closely comparable to provisions in other states. For the foregoing reasons, Petitioners Liberty Mutual Insurance Company and

Liberty Mutual Fire Insurance Company respectfully urge this Court to review the decision of the Supreme Judicial Court of Massachusetts.

Respectfully submitted,

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Liberty Mutual Fire Insurance Company

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APPENDIX

TABLE OF CONTENTS

A. Opinion of the Supreme Judicial Court of Massachusetts, dated July 11, 1989 ..... A1

B. Opinion of the Massachusetts Appellate Tax Board, promulgated May 2, 1988.....A12

C. Opinion of the Supreme Judicial Court of Massachusetts in *Commissioner of Revenue v. Massachusetts Mutual Life Insurance Company & others,* 384 Mass. 607 (1981) A26

D. Final Judgment of the Supreme Judicial Court of Massachusetts, entered July 11, 1989.....A43

APPENDIX A

LIBERTY MUTUAL INSURANCE COMPANY vs. COMMISSIONER OF REVENUE.
(and nine companion cases[1]).

Suffolk, March 6, 1989. – July 11, 1989.

Present: LIACOS, C.J., WILKINS, ABRAMS, LYNCH, O'CONNOR, JJ.

Taxation, Insurance Company excise. *Constitutional Law,* Taxation, Equal protection of laws.

The State excise tax imposed on domestic insurance companies by G. L. c. 63, § 22A, is a "nondiscriminatory franchise or other non-property" tax permitted under 31 U.S.C. § 3124 (a), with the result that interest earned by insurance companies on Federal obligations were subject to taxation. [354-356]

Where G. L. c. 63, § 22A, setting forth the provisions of a State excise tax, requires the interest earned on both

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[1] Five appeals by Liberty Mutual Fire Insurance Company were before the Appellate Tax Board. Four other appeals by Liberty Mutual Insurance Company were also before the board. The board rendered one decision for the cases. See note 3, *supra.*

The plaintiffs have requested we await the outcome of a bank tax case currently awaiting decision by the board. We deny that request.

We acknowledge the assistance of the amicus brief of Baybank Middlesex and its affiliates, and State Street Bank and Trust Company.

State and Federal obligations to be included in calculating the base on which the tax is levied, the excise tax was not discriminatory and did not conflict with the provisions of Federal law set forth in 31 U.S.C. § 3124 (a). [357]

The State excise tax imposed on domestic insurance companies by G. L. c. 63, § 22A, does not violate the contracts clause of the United States Constitution. [357]

The power of the Commissioner of Insurance exercisable under the provisions of G. L. c. 63, § 22A, does not constitute an unlawful delegation by the Legislature of its taxing power. [358]

The distinctions among taxpayers set forth in the State excise tax statute, G. L. c. 63, § 22A, had a rational basis, thus were not vulnerable to challenge under the equal protection clause or under Part II, c. 1, § 1, art. 4, of the Massachusetts Constitution, which prohibits unreasonable taxes. [358-359]

APPEAL from a decision of the Appellate Tax Board.

The Supreme Judicial Court on its own initiative transferred the case from the Appeals Court.

Mark A. Michelson (Samuel B. Bruskin & James F. Whipple with him) for the taxpayers.

Thomas A. Barnico, Assistant Attorney General, for the Commissioner of Revenue.

Edward F. Hines, Jr., & Robert M. Buchanan, Jr., for Baybank Middlesex & others, amici curiae, submitted a brief.

ABRAMS, J. Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company (companies) appeal from a decision of the Appellate Tax Board (board). The board upheld the decision of the Commissioner of Revenue (Commissioner), who denied the companies' applications for abatement on the excise tax imposed on domestic insurance companies by G. L. c. 63, § 22A (1986 ed.).[2] The companies argue that the excise tax imposed by G. L. c. 63, § 22A, violates various provisions of the Federal and State Constitutions. We transferred the cases to this court on our own motion. We affirm the board's decision.

The companies are domestic insurance companies within the meaning of § 22A. Both companies filed excise tax returns for the taxable years ending in 1975.[3] As § 22A requires, the companies included in their total gross

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[2] General Laws c. 63, § 22A, provides in relevant part: "Every domestic insurance company coming within the scope of the definition of a domestic company in section one of chapter one hundred and seventy-five . . . shall annually pay, as part of its excise imposed under this chapter, an amount equal to one per cent of its total gross investment income earned during the preceding calendar year, as reported in its annual statement for said year filed with the commissioner of insurance and as shown in Exhibit 3 of said statement for a life insurance company or in Item 10, Column 8, Part 1, of the Underwriting and Investment Exhibit for any other domestic insurance company."

An excise tax is a tax on the performance of an act, the conduct of an occupation, or the enjoyment of a privilege, as opposed to a tax on income. See, e.g., *Boston Safe Deposit & Trust Co. v. Commissioner of Corps. & Taxation*, 309 Mass. 37, 43 (1941); Black's Law Dictionary 506 (5th ed. 1979).

[3] The parties have agreed to use 1975 as an appropriate test year for the issues raised by the companies.

investment incomes the interest from Federal bonds, treasury notes, and other Federal obligations, as well as interest on bonds exempt from taxation under Massachusetts law. The companies paid taxes which reflected the interest on the Federal and State obligations. The companies then applied to the Commissioner for abatement of the entire excise tax for the years 1971-1977. The Commissioner refused to abate the excise tax, and the board upheld the Commissioner's decision.[4]

1. *Supremacy clause.* The companies argue that § 22A violates the supremacy clause of the United States Constitution because it conflicts with a Federal statute, 31 U.S.C. § 3124(a).[5] This statute exempts all Federal bonds and other Federal obligations from all taxation except for "nondiscriminatory franchise or other non-property

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[4] The accuracy or computation of the amounts of the excise taxes assessed, reported or paid for each tax year is not before us.

[5] Title 31 U.S.C. § 3124(a) provides in relevant part: "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." In 1975, this statute was codified at 31 U.S.C. § 742.

taxes." *Id.*[6] The companies argue that the State excise tax of G. L. c. 63, § 22A, does not fall within the exception in the Federal statute and therefore § 22A impermissibly conflicts with the Federal exemption for Federal bonds and obligations. The Commissioner argues that the Massachusetts excise tax of § 22A is a "nondiscriminatory franchise or other nonproperty tax" which is expressly permitted by the terms of the Federal statute. We agree with the Commissioner.

We have already considered this issue. The precedent set by *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co.*, 384 Mass. 607, 608, 619 (1981), compels the conclusion that "[t]he tax imposed by § 22A is a 'nondiscriminatory franchise or other non-property tax permitted by [§ 3124(a)] . . . and therefore, the Commissioner is correct in [his] assertion that the interest earned on Federal obligations may properly be included in an excise tax." *Id.* at 616-617. The companies urge us to abandon our holding in *Massachusetts Mut. Life Ins. Co., supra.* We decline to do so.

"The label by which a tax is known should not control the constitutional principles by which it is judged." *Aronson v. Commonwealth*, 401 Mass. 244, 248 (1987), quoting *George S. Carrington Co. v. State Tax Comm'n*, 375 Mass. 549, 552 n.3 (1978). See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288 (1977). In *Commissioner of Revenue v.*

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[6] A franchise tax is a tax on the privilege of doing business within a State, as opposed to a tax on income. See, e.g., *First Fed. Sav. & Loan Ass'n v. State Tax Comm'n*, 372 Mass. 478, 486 (1977). *Provident Inst. for Sav. v. Commonwealth*, 259 Mass. 124, 126 (1927).

Massachusetts Mut. Life Ins. Co., we carefully looked behind the labels of the State statute to determine whether the excise tax of § 22A was a nondiscriminatory franchise or other nonproperty tax which is permitted under Federal law, or whether it was a property tax forbidden by Federal law. In our analysis, we noted that "[t]he tax measure [of § 22A] includes items that are not 'income' to the companies in the traditional sense, such as imputed home office rent, amortization of Federal investment tax credits, and earnings on assets held in connection with employee and agents' pension plans; and excludes items which are income in the traditional sense, such as capital gains. The fact that the measure of the tax mentions 'gross investment income' as reported in the annual statement does not divest the tax of its excise character. . . . Section 22A does not impose a limited income tax. Rather, it sets out a workable measure, a yardstick to calculate the value of the privilege of doing business in Massachusetts." *Id.* at 612. The United States Supreme Court has recognized that in State tax situations " 'rough approximation rather than precision' is sufficient." *International Harvester Co. v. Evatt*, 329 U.S. 416, 422 (1947), quoting *Illinois Cent. Ry. v. Minnesota*, 309 U.S. 157, 161 (1939). In enacting § 22A, "the Legislature meant to use the figure of total gross investment income as reported in the annual statement for insurance regulatory purposes as a benchmark by which to calculate the amount of excise payable for the privilege of doing business in the Commonwealth." *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co., supra* at 613-614.

The companies rely on *Northwestern Mut. Life Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), for the proposition that

corporate excise taxes which include interest earned on Federal obligations necessarily must be struck down. The United States Supreme Court "has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property." *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. 492, 535 (1956). In 1981, we also noted that, "[s]ince the 1930's . . . the Supreme Court has upheld corporate excise taxes which include income immune from direct taxation. In a series of cases, the Supreme Court ruled: '[T]he corporate excises may be measured by income immune from a direct tax thereon.' " *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co.*, *supra* at 615, quoting Powell, The Waning of Intergovernmental Tax Immunities, 58 Harv. L. Rev. 633, 633 (1945). We therefore continue to adhere to our conclusion that § 22A is a franchise or other nonproperty tax.[7]

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[7] Some State courts have reached similar conclusions. See, e.g., *Department of Revenue* v. *First Union Nat'l Bank*, 513 So. 2d 114, 119 (Fla. 1987), appeal dismissed, 108 S. Ct. 1253 (1988); *State Dep't of Assessments & Taxation* v. *Maryland Nat'l Bank*, 310 Md. 664 (1987), appeal dismissed, 108 S. Ct. 2812 (1988); *Centerre Bank* v. *Director of Revenue*, 744 S.W.2d 754 (Mo. 1988); *Garfield Trust Co.* v. *Director of Taxation*, 102 N.J. 420, 434, appeal dismissed, 479 U.S. 925 (1986). These cases all hold that franchise taxes based on a measure including interest from Federal and State obligations qualify under 31 U.S.C. § 3124(a) as "nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations."

The cases cited by the plaintiffs do not compel the opposite conclusion. See, e.g., *First Fed. Sav. & Loan Ass'n* v. *Commonwealth*, 515 Pa. 369 (1987) (under Pennsylvania law, statute providing that thrift institutions "shall pay . . . State excise

(Continued on following page)

The companies argue, however, that, even if § 22A is a franchise tax, it is a discriminatory franchise tax and thus not permitted by the Federal statute. The companies assert that § 22A discriminates between Federal and State obligations because Massachusetts law forbids any tax on the interest of State obligations, and thus only Federal obligations are taxed pursuant to § 22A. The short answer to this peculiar argument is that, contrary to the companies' assertion, § 22A requires taxpayers to include in their excise tax base the interest on State obligations as well. Concededly, the enabling acts of certain State authorities exempt State bonds issued by those authorities from taxation on income or property.[8] However, these State obligations are not exempt from forming part of the

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tax . . . upon . . . annual net earnings or income, for the privilege of doing business in [Pennsylvania]" could not be read to require inclusion of interest from State obligations); *Dale Nat'l Bank v. Commonwealth*, 502 Pa. 170 (1983) (tax, as calculated, was a property tax and not a franchise tax); *Federal Prods. Corp.* v. *Norberg*, 429 A.2d 447, 450 (R.I. 1981) (interest from Federal securities could not be included in income for assessment of business corporation tax, as opposed to corporate franchise tax).

[8] For example, the enabling acts of the following authorities exempt the bond interest of the authorities from State taxation: the Massachusetts Bay Transportation Authority, G. L. c. 161A, § 18 (St. 1964, c. 563, § 18); the University of Massachusetts Building Authority, St. 1960, c. 773, § 15; and the Massachusetts Housing Finance Agency, St. 1966, c. 708, § 12. During the years with which we are concerned, the companies held bonds of these three authorities.

base on which an excise tax is levied on the privilege of doing business in Massachusetts. See, e.g., *Commissioner of Revenue* v. *Massachusetts Mut. Life Ins. Co., supra* at 617-618 (tax exempt status of income derived from projects pursuant to c. 121A, did not prevent inclusion in the tax base for excise tax purposes).

This conclusion disposes of the companies' argument that the Commissioner's attempt to tax Massachusetts authority bonds impairs a "covenant" made by the Legislature that the bonds remain free from taxation. According to the companies, this impairment violates the contracts clause of the United States Constitution. Art. 1, § 10, of the Constitution of the United States. However, we have concluded above that the fact that the tax base for the excise of § 22A includes the interest earned on State bonds does not mean that the Legislature has imposed a property tax on these bonds. Therefore, no covenant has been broken.

Because § 22A constitutes a "nondiscriminatory franchise or other nonproperty" tax within the meaning of 31 U.S.C. § 3124(a), the imposition of this excise tax does not conflict with Federal law.

2. *Delegation of taxing power.* The companies argue that § 22A grants the Commissioner "the absolute power to determine the excise tax unchecked by any clear statement of policy, and without any judicial or administrative supervision whatsoever." The companies therefore assert that § 22A embodies a delegation by the Legislature of its taxing power in violation of the Massachusetts Constitution. We do not agree. This argument also is precluded by *Commissioner of Revenue* v. *Massachusetts Mut. Life Ins. Co.,*

supra. There we held that under § 22A, "[t]he Commissioner of Insurance does not include or exclude items in the annual statement for the purpose of affecting the amount of the excise tax, but rather for the purpose of regulating the companies. His power to affect the amount of tax payable under the formula established by the Legislature is purely incidental to those regulatory powers. The taxing power remains with the Legislature as provided in the State Constitution. Part II, c. 1, § 1, art. 4, of the Massachusetts Constitution." *Id.* at 610.

3. *Equal protection and reasonableness*. The companies assert that § 22A discriminates against domestic insurance companies by taxing them more heavily than foreign companies and other types of domestic businesses. The companies argue that § 22A, therefore, violates their rights to equal protection of the laws under the Fourteenth Amendment to the United States Constitution and their right to be free from unreasonable taxation under Part II, c. 1, § 1, art. 4, of the Massachusetts Constitution. We do not agree.

"Any distinction in a tax statute that has a rational basis will survive a challenge under the equal protection clause." *Smith* v. *Commissioner of Revenue*, 383 Mass. 139, 141 (1981). See *Seiler Corp.* v. *Commissioner of Revenue*, 384 Mass. 635, 639 (1981). Assuming without deciding that the taxpayers bear a heavier burden than foreign insurance companies doing business in Massachusetts, it is not unreasonable to tax domestic insurance companies differently. The Legislature could rationally decide that the benefits the State accords to domestic insurance companies justify treating them differently from foreign insurance companies. See *Mary C. Wheeler School, Inc.* v.

Assessors of Seekonk, 368 Mass. 344, 346-350 (1975). The Legislature could also rationally conclude that the nature of the insurance business warrants treating insurance companies differently from other types of companies. See *Massachusetts Auto. Rating & Accident Prevention Bureau* v. *Commissioner of Ins.*, 381 Mass. 592, 604-605 (1980).

Similarly, the companies' argument that § 22A is an unreasonable tax in violation of Part II, c. 1, § 1, art. 4, of the Massachusetts Constitution is without merit. "[T]he Legislature's choice of gross investment income as reported for regulatory purposes as a rough approximation of the value of the privilege of doing business in the Commonwealth is reasonable." *Commissioner of Revenue* v. *Massachusetts Mut. Life Ins. Co.*, *supra* at 613.

The decision of the board is affirmed.

So ordered.

APPENDIX B

COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

LIBERTY MUTUAL INSURANCE CO.	v.	COMMISSIONER OF REVENUE
LIBERTY MUTUAL FIRE INSURANCE CO.	v.	COMMISSIONER OF REVENUE

Docket Nos. 86036, 86037
122512, 122513, 122514, 122515, 125133, 125134, 125135, 125136

Promulgated: May 2, 1988

This is an appeal under the formal procedure pursuant to G.L. c.62C s.39, as amended, from the refusal of the appellee to abate insurance company excises assessed under G.L. c.63 s.22A for the periods 1971 through 1977.

These findings of fact and report are made pursuant to a request by the appellants under G.L. c.58A s.13, as amended, and Rule 32 of the Rules of Practice and Procedure of the Appellate Tax Board.

Mark A. Michelson, Esq., for the appellant.

Robert A. Carleo, Jr., Esq., for the appellee.

FINDINGS OF FACT AND REPORT

The appellants are domestic insurance companies as defined in G.L. c.175 s.1, and each has its principal place of business in Massachusetts. Each filed its domestic insurance company premium excise return on Form 63-22

for its taxable year ending December 31 of each of the years 1971 through 1977. Form 63-22 includes the information required for assessment of the excise on total gross investment income levied by G.L. c.63 s.22A. The board's findings are based on a Statement of Agreed Facts covering returns for each appellant's 1975 taxable year, which the parties agree is an appropriate test year for the issues raised for all the tax years at issue.

Liberty Mutual omitted from its 1975 return imputed home office rental included in Part I, column 8, line 10 of the Underwriting and Investment Exhibit of its annual statement filed with the Commissioner of Insurance. The Commissioner of Revenue assessed an additional excise, which Liberty Mutual paid, based on the inclusion of the imputed home office rent in the total gross investment income. Liberty Mutual and Liberty Fire each included in its total gross investment income interest earned from bonds, Treasury Notes, and other United States obligations, as well as interest on bonds which were exempt from taxation under Massachusetts law, and paid the excises resulting from the inclusion of these items. Each appellant made timely application for abatement of its entire excise on gross investment income. The appellee denied all of the applications, and the appellants filed timely appeals to the Appellate Tax Board.

There is no dispute that the items at issue were reportable on the Underwriting and Investment Exhibit of the annual statement filed with the Commissioner of Insurance. The board finds that the items were reportable and that the appellants reported them with their annual statements.

Insofar as it is a question of fact, the board finds that the items of investment income at issue were properly includible in the excise assessments based on the appellants' gross investment income and that the appellee correctly assessed the excise under G.L. c.63 s.22A.

OPINION

The excise whose assessments are the subject of these appeals is imposed by G.L. c.63 s.22A, which provided in pertinent part as follows during the years in question:

> Every domestic insurance company coming within the scope of the definition of a domestic company in section one of chapter one hundred and seventy-five shall annually pay, as part of its excise imposed under this chapter, an amount equal to one per cent of its total gross investment income earned during the preceding calendar year, as reported in its annual statement for said year filed with the commissioner of insurance and as shown . . . in Item 10, Column 8, Part I, of the Underwriting and Investment Exhibit. . . .

The appellants raise the following challenges to the assessments of their gross investment income made under this provision:

1. The inclusion of interest from federal obligations violates the Supremacy Clause of Article VI of the United States Constitution because it taxes income from federal obligations in conflict with 31 USC s.742;

2. The inclusion of interest from obligations of Massachusetts governmental authorities conflicts with exemption provisions of the authorities' enabling statutes and violates

the Contracts Clause of the United States Constitution;

3. The method provided for determining gross investment income delegates the taxing power of the General Court in violation of the Massachusetts Constitution;

4. The excise is not a reasonable excise within the taxing power granted to the General Court by the Massachusetts Constitution.

Inclusion of Interest from Federal Obligations

Article VI of the United States Constitution provides in part:

> This constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the constitution or laws of any state to the contrary notwithstanding.

During the years at issue Rev. Stat. s.3701 (codified then as 31 U.S.C. s.742, now as 31 U.S.C. s.3124(a)), provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury Notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, *except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations*. . . . [Emphasis added.]

The Supreme Court's decisions "have treated s.742 as principally a restatement of the constitutional rule." *Memphis Bank & Trust*, 459 U.S. 392, 397 (1983); *First Nat. Bank of Atlanta*, 470 U.S. 583, 593 (1985).

In *Northwestern Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), the United States Supreme Court held that an annual license fee of 3% of gross income could not validly be applied to interest from federal obligations. Distinguishing a tax on gross income from a tax on net income, the court pointed out that the state statute "undertook to impose a charge of 3 per cent. upon every dollar of interest received by the Company from United States bonds" and thus amounted to "an imposition upon the bonds themselves" and went "beyond the power of the State." 275 U.S. at 141. In more recent cases the Court has struck down state franchise taxes which discriminated against federal obligations by including the obligations themselves or the income earned on them in the tax base while exempting state obligations. *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929); *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855 (1983), which the appellants cite, expressly distinguishes the tax on bank shares involved in that case from a franchise tax and acknowledges that "Congress must have believed that franchise . . . taxes required federal obligations to 'be considered, directly or indirectly, in the computation of the tax'; otherwise, the specific exemptions for these taxes would have been superfluous." 463 U.S. AT 864.

The Supreme Court has consistently held, however, that Rev. Stat. s.3701 did not prohibit the imposition of nondiscriminatory taxes on franchises, even if the value

of the franchise was measured by assets, including federal obligations. Thus, under the statute permitting states to tax the net income of national banks, the Supreme Court held that a state tax on the net income of national banking associations, including tax-exempt income from federal securities and not discriminating between exempt and non-exempt income, did not unconstitutionally tax the exempt income. *Tradesmens Nat. Bank v. Oklahoma Tax Comm.*, 309 U.S. 560 (1940). In *Werner Machine Co. v. Director of Div. of Taxation*, 350 U.S. 492 (1956), the Supreme Court upheld a nondiscriminatory tax on domestic corporations, found by the state's highest court to be a bona fide franchise tax, which was measured by the "net worth" of the corporation, including federal bonds. The Supreme Court has also held that the requirements of Rev. St. s.3701 were satisfied for purposes of a tax on the fair market value of bank shares (determined by dividing the bank's net worth by the number of outstanding shares) by deducting from net worth only the percentage of assets attributable to federal obligations rather than the full value of the obligations, where on the bank's balance sheet some of the federal obligations were represented by liabilities and some by net worth. *First Nat. Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985). "In sum, ever since Gehner [*Missouri ex rel. Missouri Ins. Co. v. Gehner*, 281 U.S. 313 (1930)], each time this Court has addressed the scope of the tax exemption for Government obligations, it has concluded that the exemption need not be a total exclusion, but, instead, may be limited by charging tax-exempt obligations and interest their fair share of related expenses or burdens." 470 U.S. at 593.

Since we do not accept the appellants' contention that income from obligations of various Massachusetts governmental authorities is exempt from the excise imposed by G.L. c.63 s.22A, we do not find that the excise discriminates against federal obligations.

Finally, the inclusion of income from federal obligations in the measure of the excise under review has already been upheld by the Supreme Judicial Court of the Commonwealth in *Commissioner of Revenue v. Massachusetts Mutual Life Ins. Co.*, 384 Mass. 607 (1981). In its discussion of this issue the Court stated, "Historically, it appears that in the early part of the century the Supreme Court struck down corporate excise taxes that included interest earned on Federal obligations. *Northwestern, supra* [275 U.S.] at 141 (corporate excise tax measured by 'gross income from all sources'). *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929) (corporate excise tax measured by net income). Since the 1930's, however, the Supreme Court has upheld corporate excise taxes which include income immune from taxation. In a series of cases the Supreme Court ruled: '[T]he corporate excises may be measured by income immune from a direct tax thereon.' [Citations omitted.] . . . We conclude that the tax imposed by s.22A is a 'nondiscriminatory franchise or other nonproperty tax,' permitted by s.742, . . . and therefore, the Commissioner is correct in her assertion that the interest earned on Federal obligations may properly be included in the excise tax." 384 Mass. at 615-617.

Inclusion of Interest from Massachusetts Obligations

The appellants held bonds of the Massachusetts Bay Transportation Authority (MBTA), the University of Massachusetts Building Authority (UMBA), and the Massachusetts Housing Finance Agency (MHFA), all of whose enabling acts expressly exempt income from authority bonds from taxation. For the MBTA, G.L. c.161A s.18 (St. 1964 c.563 s.18) provides:

> Bonds and notes issued by the authority, their transfer and the income therefrom, including any profit made on the sale thereof, shall at all times be free from taxation within the commonwealth.

For the UMBA, St. 1960 c.773 s.15 provides:

> [T]he notes and bonds issued under the provisions of this act, their transfer and the income therefrom, including any profit made on the sale thereof, shall at all times be free from taxation within the commonwealth.

For the MHFA, St. 1966 c.708 s.12 provides:

> The commonwealth covenants with the purchasers and all subsequent holders and transferees of the notes and bonds issued by the MHFA, in consideration of the acceptance of any payment for the notes and bonds, that the notes and bonds of the MHFA, issued pursuant to this act and the income therefreom (sic) shall at all times be free from taxation.

The appellants contend that the Commissioner's inclusion of the interest on bonds of these agencies in the measure of the excise violates the plain meaning of the exemption language quoted above. They also argue that the Commissioner's interpretation of G.L. c.63 s.22A is

contrary to Corporation Excise Tax Ruling 1958-7, which expressly stated that interest on authority bonds was not a part of gross income under G.L. c.63 s.30(5) for purposes of the corporation excise where the authority's enabling act provided for an exemption from taxation within the Commonwealth. While the appellants offer this Ruling as an interpretation of the exemption provision of an enabling act, we regard it rather as an interpretation of the definition of gross income for the corporation excise. Insurance companies are engaged in a highly specialized business for which the Legislature could have provided and did provide a different measure in establishing its excise structure. Any inference that the Legislature "acquiesced in the result reached in the ruling when it later used the same language in enacting the exemption legislation at issue" (Consolidated Memorandum p. 16) would overlook this point and would at best be speculative.

The appellants also argue that although the tax is in form an excise, in substance and effect it is a tax on any interest derived from tax-exempt bonds because its amount varies directly with the amount of bond interest included in gross investment income. This argument is answered by the Court's statements quoted above from *Massachusetts Mutual* on interest from federal obligations.

The Supreme Judicial Court has upheld the inclusion of income derived from urban redevelopment projects, which were entitled to choose an excise as an alternative to the property tax, in gross investment income under G.L. c.63 s.22A. *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co*, 384 Mass. 607 (1981). This board has sustained the inclusion of interest from MHFA bonds in

net income for purposes of the bank excise imposed by G.L. c. 63 ss.1 and 2. *Capital Bank and Trust Co. v. Commissioner of Revenue,* Docket No. 120846, 3 Mass. A.T.B. Rep. 143, 1983 A.T.B. Advance Sheets 504 (October 18, 1983).

The appellants also contend that the inclusion of Massachusetts governmental authority bond interest in gross investment income subject to the excise violates the Contracts Clause (Art. I s.10 cl.1) of the United States Constitution. The excise is not levied on the bonds or their interest, however, but on the privilege of doing business in Massachusetts. *Commissioner of Revenue v. Massachusetts Mut. Life Ins. Co.,* 384 Mass. 607, 618 (1981).

In a case which, unlike *Macallen Co. v. Massachusetts, supra,* did not involve an extension of an existing tax to income previously exempt, the United States Supreme Court has held that a corporate franchise tax based on net income, including income from tax-exempt municipal bonds and making no discrimination between exempt and non-exempt income, did not impair contract obligations. *Pacific Co. v. Johnson,* 285 U.S. 480 (1932).

Delegation of Taxing Power

The appellants contend that G.L. c.63 s.22A gives the Commissioner of Insurance complete discretion over the items required to be included in total gross investment income on the annual statement, thereby conferring on him the power to determine the amount of tax due, and that since no opportunity is provided for administrative or judicial review of the exercise of this discretion, the authority given to the Commissioner of Insurance violates the prohibition against delegation of the legislative

power of taxation. See *Emerson College v. City of Boston*, 391 Mass. 415, 422 n.14 (1984).

The appellants do not appear to argue, however, that the action of the Commissioner of Insurance was improper for any reason other than the resulting inclusion of the items in question in gross investment income subject to the excise. What is at issue in these appeals is not whether the Commissioner of Insurance could properly require the inclusion of the items in question as part of the annual statement filed with him, but whether the items required to be so included could properly be also included in gross investment income for purposes of the excise imposed by G.L. c.63 s.22A. As the appellants say, G.L. c.175 s.25 provides no appeal on the propriety of the action of the Commissioner of Insurance. On the propriety of the assessment of the excise, however, the tax statutes give the taxpayers the benefit of administrative proceedings before the Commissioner of Revenue and the Appellate Tax Board, of both of which they have availed themselves, and of eventual judicial review. G.L. c.58A ss.6, 13; c.62C ss.37, 39. Although the appellants correctly point out that the Supreme Judicial Court did not consider the lack of opportunity to appeal the action of the Commissioner of Insurance in *Massachusetts Mutual, supra*, the point had no greater relevance there than here, since the Court held that the legislature had not improperly delegated the legislative power to tax. As the Court said, "The Commissioner of Insurance does not include or exclude items in the annual statement for purposes of affecting the amount of the excise tax, but rather for the purpose of regulating the companies. His power to affect the amount of tax payable under the formula established

by the Legislature is purely incidental to those regulatory powers. *The taxing power remains with the Legislature as provided in the State Constitution.*" 384 Mass. at 610 (emphasis added).

Reasonableness of Excise

The Massachusetts Constitution (Part II, c.1, s.1, art. 4) empowers the General Court to levy "reasonable excises" only. The appellants argue that the excise imposed by G.L. c.63 s.22A fails to meet this standard because it applies only to domestic insurance companies and not to foreign insurance companies or to domestic companies engaged in other businesses, and that the distinction is not justified by any additional benefit derived by domestic insurance companies from the privilege of doing business in Massachusetts. See *In re Suffolk Savings Bank for Seamen*, 151 Mass. 103, 105 (1890). In the *Massachusetts Mutual* case the Court said: "We believe that the Legislature's choice of gross investment income as reported for regulatory purposes as a rough approximation of the value of the privilege of doing business in the Commonwealth is reasonable." 384 Mass. at 613. Although the Court was speaking directly of the items included in gross investment income, the board believes that under the *Massachusetts Mutual* case and the other cases cited therein, the Legislature has considerable latitude in approximating the value of a privilege without calculating its exact relation to the values of other privileges exercised by other classes of taxpayers. G.L. c.63 imposes different excises on various classes of corporations for the privilege of doing business in Massachusetts,

and many of them distinguish between domestic and foreign corporations.

Similar considerations apply to the appellants' argument that the limitation of the excise on domestic insurance companies violates equal protection under the United States Constitution. "So long as any basis of fact can be reasonably conceived showing that the distinction made by a tax statute has a fair and rational relationship to the object sought to be accomplished, the legislative classification is not violative of equal protection principles. *Frost v. Commissioner of Corps. & Taxation*, 363 Mass. 235, 248 (1973)." *Seiler Corp. v. Commissioner of Revenue*, 384 Mass. 635, 639 (1981); see also *Smith v. Commissioner of Revenue*, 383 Mass. 139, 134 (1981). "[I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification. . . .The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it." *Madden v. Kentucky*, 309 U.S. Mass. 83, 88 (1939).

Although the appellee's brief defends the inclusion of the imputed rental value of the appellants' home office in the gross investment income measure of the excise, the appellant does not appear to contest the point, and the board considers it settled by the *Massachusetts Mutual* case.

The board's decisions for the appellee were promulgated on June 30, 1987.

APPELLATE TAX BOARD

By /s/ John J. Wall Chairman

A True Copy

Attest: /s/ Illegible
Clerk of the Board

APPENDIX C

COMMISSIONER OF REVENUE

vs.

MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY & others.[1]

Suffolk. September 16, 1981. – November 17, 1981.

Present: HENNESSEY, C.J., LIACOS, ABRAMS, & LYNCH, JJ.

Taxation, Insurance company excise. *Constitutional Law,* Taxation.

General Laws c. 63, § 22A, which imposes on a domestic insurance company an excise in an amount equal to one per cent of its total gross investment income, "as reported in its annual statement . . . filed with the Commissioner of Insurance," does not constitute an improper delegation of the legislative taxing power to the Commissioner of Insurance. [609-611]

Under G. L. c. 63, § 22A, the excise tax to be paid by domestic insurance companies is measured by total gross investment income as reported in the annual statements filed by the companies for insurance regulatory purposes even though such a measure may include items which are not gross investment income in the tax sense and exclude items that are gross investment income in the tax sense. [611-614]

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[1] The other defendants are New England Mutual Life Insurance Company and State Mutual Life Assurance Company of America.

The interest earned on Federal obligations may properly be included in "gross investment income" for the purposes of the excise tax imposed on domestic insurance companies by G. L. c. 63, § 22A, because it is a nondiscriminatory franchise tax. [614-617]

The income derived from urban redevelopment projects pursuant to G. L. c. 121A may properly be included in "gross investment income" for the purposes of the excise tax imposed on domestic insurance companies by c. 63, § 22A, since it does not constitute a direct tax upon that income but rather on the general corporate privilege of doing business. [617-618]

Income from separate account business is not part of the "total gross investment income" of domestic insurance companies for purposes of the excise tax imposed by G. L. c. 63, § 22A. [618-619]

Although items such as the fair rental value of home office buildings, earnings on assets held in connection with employee and agents' pension plans, and the amortization of Federal investment tax credits are not traditional items of income, they may properly be included in "gross investment income" for purposes of the excise tax imposed on domestic insurance companies by G. L. c. 63, § 22A. [619]

APPEAL from a decision by the Appellate Tax Board.

Stephen S. Ostrach, Assistant Attorney General, for he plaintiff.

Robert W. Meserve & Mark A. Michelson (Robert J. McGee & John N. Garner with them) for the defendants.

ABRAMS, J. The Commissioner of Revenue appeals from a decision of the Appellate Tax Board (board), which granted three domestic insurance companies an abatement on an excise tax imposed by G. L. c. 63, § 22A, inserted by St. 1971, c. 555, § 27.[2]

The three companies are domestic insurance companies within the meaning of § 22A. Each of the companies filed with the Commissioner of Insurance an annual statement of their financial condition pursuant to G. L. c. 175, § 25, and with the Commissioner of Revenue (Commissioner)[3] an excise tax return pursuant to § 22A for the year 1971. The excise tax returns reported a lesser amount of "total gross investment income" than the amount shown on exhibit 3 of the annual statements. The Commissioner notified the companies that he intended to

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[2] General Laws c. 63, § 22A, provides: "Every domestic insurance company coming within the scope of the definition of a domestic company in section one hundred and seventy-five shall annually pay, as part of its excise imposed under this chapter, an amount equal to one per cent of its total gross investment income earned during the preceding calendar year, as reported in its annual statement for said year filed with the commissioner of insurance and as shown in Exhibit 3 of said statement for a life insurance company or in Item 10, Column 8, Part I, of the Underwriting and Investment Exhibit for any other domestic insurance company." This provision is effective until January 1, 1982. St. 1977, c. 816, § 29.

[3] The state Tax Commission was reorganized under the new title of Department of Revenue in 1978. St. 1978, c. 514, § 5.

increase their gross investment incomes as reported pursuant to § 22A, and to assess them accordingly.[4] The companies paid the assessed tax and applied to the Commissioner for abatement of their 1971 excise. The Commissioner denied the applications and the companies appealed to the board.

Before the board, the companies challenged the constitutionality of § 22A claiming that, if the board were to read § 22A literally, then the statute would be unconstitutional as an improper delegation of the legislative taxing power. The companies argue and the board agreed that since the Commissioner of Insurance has authority under G. L. c. 175, § 15, to determine the contents of the insurers' annual statement filed pursuant to § 25, and since the annual statement is used to determine the amount of excise tax, § 22A, in effect, gives the Commissioner of Insurance the discretion to determine the tax imposed. The board determined that the companies may have raised a valid constitutional claim. In order to avoid constitutional doubts, the board held that § 22A "does not preclude an inquiry into the nature of the items in issue to determine whether in law and in fact they are includable in the term 'total gross investment income' for excise

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[4] The increased excise was based upon the inclusion of the following items which were included in the annual statement but not in the excise tax return: (1) interest on obligations of the United States; (2) income derived from G. L. c. 121A projects; (3) income from separate account business; (4) earnings on assets held in connection with employee and agents' pension plans; (5) the fair rental value of home office buildings; (6) management fees; (7) "ex-dividends" on certain securities; and (8) amortization of Federal investment tax credits.

tax purposes, although required to be reported in any event as bearing on the company's financial condition for regulatory purposes."

The board then independently examined eight categories of income (see note 4, *supra*) and determined that the eight categories were not "gross investment income" for tax purposes.[5] The board entered a decision granting the requested abatements.

1. *The constitutionality of* § 22A. The over-all statutory pattern of § 22A does not involve the delegation of legislative authority. General Laws c. 175, § 25, permits the Commissioner of Insurance to determine the contents of the insurers' annual statement for the "purpose of eliciting a complete and accurate exhibit of the condition and transactions of the companies." Section 25 also allows the Commissioner of Insurance to adopt "the latest applicable form of annual statement approved by the National Association of Insurance Commissioners." The Commissioner of Insurance uses the information contained in this statement to discharge his "duty to exercise a broad surveillance over the operations of companies with a view to instituting procedures and recommending changes which might prevent or reduce the likelihood of unsuccessful ventures." *Commissioner of Ins. v. First Nat'l Bank*, 352 Mass, 74, 79-80 (1967).

The Commissioner of Insurance does not include or exclude items in the annual statement for the purpose of affecting the amount of the excise tax, but rather for the

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[5] Both the board and the companies concede that not all of these items are income in the traditional sense.

purpose or regulating the companies. His power to affect the amount of tax payable under the formula established by the Legislature is purely incidental to those regulatory powers. The taxing power remains with the Legislature as provided in the State Constitution. Part II, c. 1, § 1, art. 4, of the Massachusetts Constitution.

Although the Commissioner of Insurance may incidentally affect the amount of the tax payable, he may not do so except through acts of independent legal significance. "It may . . . be laid down as a general proposition that where a legislature enacts a specific rule for fixing a rate of taxation, by which rule the rate is mathematically deduced from facts and events occurring within the year and created without reference to the matter of that rate, there is no abdication of the legislative function, but, on the contrary, a direct legislative determination of the rate." *Michigan Cent. R.R. v. Powers*, 201 U.S. 245, 297 (1906). Thus, "[t]he fact that [a] deduction allowed to a Federal savings and loan association is determined by a Federal agency decision concerning reserve requirements is not an unconstitutional delegation of legislative powers in violation of . . . the Declaration of Rights of the Constitution of the Commonwealth. . . . In numerous instances a taxpayer's obligation is affected by the conduct of other persons, but those other persons are not exercising the authority of the Legislature to tax. *Their action may influence the amount of tax payable, but the taxing power has not been delegated to them*" (emphasis supplied). *First Fed. Sav. & Loan Ass'n v. State Tax Comm'n* 372 Mass. 478, 491 (1977). See *Parker Affiliated Cos. v. Department of Revenue*, 382 Mass. 256, 266 (1981) ("the prospective

incorporation of Federal tax law does not constitute impermissible delegation of legislative authority").

The companies claim that three *Opinions of the Justices* support the board's conclusion that § 22A creates "constitutional doubts." We do not agree. Those opinions involved pending legislation in which the Justices concluded that the legislative authority to enact substantive measures had been delegated. See, e.g., *Opinion of the Justices*, 334 Mass. 716 (1956) (power to appropriate funds); *Opinion of the Justices*, 328 Mass. 674 (1952) (power to make structural changes in the form of town government); *Opinion of the Justices*, 239 Mass. 606 (1921) (power to establish offense to be punished by fine or imprisonment). See *Corning Glass Works v. Ann & Hope, Inc.* 363 Mass. 409 (1973). In each of these instances the delegation of legislative authority was the major thrust of the pending legislation. We believe that § 22A differs markedly from the legislation under consideration in those *Opinions of the Justices*.

However, the Legislature has "[g]reat latitude of discretion . . . in determining . . . the standard or measure to be adopted as the foundation of the proposed excise [tax]." *Connecticut Mut. Life Ins. Co. v. Commonwealth*, 133 Mass. 161, 163 (1882). In adopting exhibit 3, the Legislature determined the standard of measure to be used. Hence, G. L. c. 63, § 22A, is not an improper delegation of the legislative power to tax.

2. *The meaning of "total gross investment income" in § 22A.* In the absence of constitutional doubts our task is to determine what the Legislature intended to subject to the excise tax by use of the words "total gross investment

income earned during the preceding calendar year, as reported in its annual statement." There is nothing in G. L. c. 63, or its legislative history, which is instructive.

The insurance companies assert that the Legislature intended to use gross investment income, in the tax sense, only to the extent that it is required to be reported in the annual statement. Thus, an item would become part of the excise tax measure only if it was both an item of actual gross income, as defined for tax purposes, *and* was required to be reported in the annual statement. Since the board was concerned with the constitutionality of § 22A, it adopted the companies' argument and went on to consider eight separate items of income included by the companies in exhibit 3 but excluded on their excise return (see note 4, *supra*).

Our analysis begins with the underlying premise that the excise tax imposed on the insurance companies by § 22A is an excise tax, not an income tax. The tax measure includes items that are not "income" to the companies in the traditional sense, such as imputed home office rent, amortization of Federal investment tax credits, and earnings on assets held in connection with employee and agents' pension plans; and excludes items which are income in the traditional sense, such as capital gains. The fact that the measure of the tax mentions "gross investment income" as reported in the annual statement does not divest the tax of its excise character. As we said in *Associated Indus. of Mass., Inc. v. Commissioner of Revenue*, 378 Mass. 657, 667 (1979): "The fact that a tax on the exercise of a privilege is adjusted in whole or in part to property values does not deprive the tax of its character as an excise." The tax at issue is imposed on the insurers

for the privilege of doing business in the Commonwealth. *State Tax Comm'n v. John Hancock Mut. Life Ins. Co.*, 341 Mass. 555, 559 (1960). Black's Law Dictionary 506 (5th ed. 1979). Section 22A does not impose a limited income tax. Rather, it sets out a workable measure, a yardstick to calculate the value of the privilege of doing business in Massachusetts.

The only limitation upon the Legislature's use of its excise taxing power is that the tax be reasonable. *Connecticut Mut. Life Ins. Co. v. Commonwealth, supra* at 163. "States are permitted to make fair approximations of the value of . . . privileges in imposing excises upon the corporations which they have created. . . . [We recognize] that in . . . State tax situations, ' "rough approximation rather than precision" is sufficient.' " *Springfield Ins. Co. v. State Tax Comm'n*, 342 Mass. 505, 513 (1961), quoting from *International Harvester Co. v. Evatt*, 329 U.S. 416, 422 (1947). We believe that the Legislature's choice of gross investment income as reported for regulatory purposes as a rough approximation of the value of the privilege of doing business in the Commonwealth is reasonable. That the excise tax measure may include items that are not gross investment income in the tax sense, and exclude items that are gross investment income in the tax sense does not make the Legislature's choice unreasonable.

Additionally, the argument advanced by the insurance companies distorts the language and form used by the Legislature. The insurance companies argue that the statute should be read as creating three independent tests. To become an element of the tax base an item must be (1) an item of gross investment income; (2) earned during the preceding calendar year; and (3) required to

be reported in the annual statement. The companies' interpretation is strained. If the Legislature had meant to adopt such a three-part test it could have adopted appropriate language. Indeed, the Legislature could have broken the section into subparts if it meant to convey such a meaning.

Instead of a three-part test, the Legislature chose a unitary concept: "total gross investment income earned during the preceding calendar year, as reported in the annual statement." The "annual statement" contains only items of gross investment income reported for regulatory purposes. By using this language, the Legislature obviously chose this regulatory figure as a rough approximation of the value of the privilege of doing business in Massachusetts. We conclude that the Legislature meant to use the figure of total gross investment income as reported in the annual statement for insurance regulatory purposes as a benchmark by which to calculate the amount of excise payable for the privilege of doing business in the Commonwealth.

3. *The items excluded by the board.* We briefly discuss the items of income excluded by the board.

a. *Interest earned on Federal obligations.* One of the items reported to the Commissioner of Insurance on the annual statement, and consequently used in measuring the amount of the excise tax, was interest on obligations of the United States. The insurance companies argue that § 22A cannot constitutionally include the interest earned on Federal obligations in the calculation of the tax base against which the excise is measured since obligations of

the United States are exempt from State taxation. The board agreed with the companies.

Both the board and the companies relied on *Northwestern Mut. Life Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927). In that case, the Supreme Court of the United States struck down a Wisconsin statute that imposed on insurance companies an annual license fee in the amount of three per cent of "gross income from all sources." *Id*, at 138. The Court held that the fee was fundamentally a tax upon gross income and not a true franchise tax: "Here the statute undertook to impose a charge of 3 per cent. upon every dollar of interest received by the Company from United States bonds. . . . This amounts, we think, to an imposition upon the bonds themselves and goes beyond the power of the State." *Id.* at 141. In its opinion the board pointed to various Supreme Court cases, see, e.g., *Pacific Co. v. Johnson*, 285 U.S. 480 (1932), in which a franchise tax measured by a percentage of *net* income was upheld. As a result, the board determined that the Supreme Court has established a distinction between an excise tax based on gross income and one based on net income. The board concluded that the tax imposed by § 22A was a direct tax on gross income and, therefore, was invalid under *Northwestern, supra.*

We think that the fundamental issue in cases concerning the validity of State excise taxes under the supremacy clause of the Constitution is not whether the measuring base relies upon gross income or net income. Rather, "the issue in the application of state statutes relating to corporations is whether the tax is a franchise tax or a property tax. If the subject of the tax is the corporate franchise, government obligations or the interest thereon may be

included in the measure of the tax. But if the subject of the tax is the capital or the property of the corporation, the tax will be deemed an invalid tax on the government obligations." J. Nowak, R. Rotunda & J. Young, Constitutional Law 370 (1978). Compare *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. 492 (1956), with *Society for Sav. v. Bowers*, 349 U.S. 143 (1955), and *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665 (1950). We agree with the Commissioner that § 22A is a tax on the corporate franchise.

Historically, it appears that in the early part of the century the Supreme Court struck down corporate excise taxes that included interest earned on Federal obligations. *Northwestern, supra* at 141 (corporate excise tax measured by "gross income from all sources"). *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929) (corporate excise tax measured by net income). Since the 1930's, however, the Supreme Court has upheld corporate excise taxes which include income immune from direct taxation. In a series of cases the Supreme Court ruled: "[T]he corporate excises may be measured by income immune from a direct tax thereon." Powell, The Waning of Intergovernmental Tax Immunities, 58 Harv. L. Rev. 633, 633 (1945). See *Educational Films Corp. v. Ward*, 282 U.S. 379 (1931); *Pacific Co. v. Johnson*, 285 U.S. 480 (1932); *New York ex rel. N. Fin. Corp. v. Lynch*, 290 U.S. 601 (1933); *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. 492 (1956). See also *Home Ins. Co. v. New York*, 134 U.S. 594 (1890).

"[A] tax on the corporate franchise . . . is valid despite the inclusion of federal bonds in the determination of net worth. This Court has consistently upheld franchise taxes measured by a yardstick which includes

tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property." *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. at 494.[6] In *Home Ins. Co. v. New York*, 134 U.S. 594, 599 (1890), the Supreme Court stated: "It is not a tax in terms upon the capital stock of the company, nor upon any bonds of the United States composing a part of that stock. The statute designates it a tax upon the 'corporate franchise or business' of the company, and reference is only made to its capital stock and dividends for the purpose of determining the amount of the tax to be exacted each year."

The rule established by the cases is embodied in 31 U.S.C. § 742 (1976).[7] *Reuben L. Anderson-Cherne, Inc. v. Commissioner of Taxation*, 303 Minn. 124, 128, appeal dismissed, 423 U.S. 886 (1975). We conclude that the tax imposed by § 22A is a "nondiscriminatory franchise or other nonproperty tax," permitted by § 742, see point 2, *supra*, and therefore, the Commissioner is correct in her

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[6] The Supreme Court distinguished a case upon which the board relied, *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665 (1950), on the basis that the tax was a direct tax on the property of the corporation. The Court stated: "*New Jersey Realty* . . . on which appellant relies, is distinguishable, in that it did not involve a franchise tax, but rather a tax whose legal incidence this Court found to be upon the intangible assets of the corporation." *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. 492, 494 (1956). Likewise, in *Society for Sav. v. Bowers*, 349 U.S. 143, 146 (1955), upon which the board also relied, the Court held the tax involved therein invalid stating: "No claim is made that the taxes constituted a franchise tax or some other kind of privilege tax."

[7] Section 742 reads as follows: "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other

(Continued on following page)

assertion that the interest earned on Federal obligations may properly be included in the excise tax.

b. *Income derived from c. 121A projects.* Massachusetts Mutual and State Mutual have undertaken urban redevelopment projects pursuant to G. L. c. 121A.[8] The income derived from those projects was required to be reported in exhibit 3 of the annual statement. General Laws c. 121A, § 10, provides that Urban Redevelopment Corporations "shall not be required to pay any tax, excise, or assessment to or for the commonwealth . . . provided, however, that . . . any such corporation shall be required to pay . . . the excises and sums respectively prescribed by this section and section fifteen. . . ." The excise imposed by § 10 is in lieu of local

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(Continued from previous page)

obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, *except non-discriminatory franchise or other nonproperty taxes in lieu* thereof imposed on corporations . . . (emphasis supplied).

The legislative history makes clear that the purpose of the amendment was to clarify existing law: "the bill makes it clear that both the principal and interest on U.S. obligations are exempt from all State taxes except nondiscriminatory franchises, etc., taxes." S. Rep. No. 909, 86th Cong., 1st Sess., reprinted in [1959] U.S. Code Cong. & Ad. News 2769, 2769.

[8] General Laws c. 121A, § 2, as appearing in St. 1960, c. 652, § 2, provides in part: "[T]he provisions of this chapter will stimulate the investment of private capital in blighted open, decadent or sub-standard areas, and in the construction, maintenance and operation in such areas of needed decent safe and sanitary residential, commercial, industrial, institutional, and recreational buildings. . . ."

property taxes from which the project is exempt. *Opinion of the Justices*, 341 Mass. 760, 774 (1960).

General Laws c. 121A, § 18 (*g*), authorizes insurance companies to undertake c. 121A projects and provides: "So much of section ten as applies to the taxation of a corporation organized under section three shall apply to an insurance company only with respect to a particular project or to particular projects, and such company shall remain subject to all other taxation imposed by law with respect to its other activities and property." Since an insurance company pays an excise tax under § 10 for the privilege of undertaking c. 121A projects, the board held that the Legislature could not have intended to include c. 121A income again in the § 22A excise tax measure.[9]

The tax levied by § 22A is an excise imposed for the privilege of doing business in Massachusetts. *State Tax Comm'n v. John Hancock Mut. Life Ins. Co.*, 341 Mass. 555, 559 (1960). In order to roughly approximate the value of that privilege, *Springfield Ins. Co. v. State Tax Comm'n*, 342 Mass. 505, 513 (1961), the Legislature chose to measure the excise by gross investment income as reported for regulatory purposes. Although the figure reflects, to a certain extent, income from c. 121A projects, it does not retain that characteristic for tax purposes. As we said in *Springfield Ins.*, comparing the insurance excise in nature and impact to the excise on savings banks: " 'The subject

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[9] The board was concerned with potential problems of double taxation. See *DeBlois v. Commissioner of Corps. & Taxation*, 276 Mass. 437, 439 (1931). However, § 22A imposes a tax on the corporate franchise and raises no problems of double taxation.

to be taxed was the . . . existing value of the franchises . . . that is, the amount of benefit . . . which the charter . . . conferred on those who held it and enjoyed its privileges. . . . The excise is not laid on the business which each . . . [company] has transacted' during a preceding period, but 'upon the value of the franchise' at the end of the period." *Id*, at 508, quoting from *Commonwealth v. People's Five Cents Sav. Bank*, 5 Allen 428, 437-438 (1862).

Section 22A does not impose an excise on the privilege of undertaking any particular c. 121A project, but rather on the general corporate privilege of doing business. The excise levied by § 22A is imposed solely on the privilege of the carrying on or doing of business by the companies, and not upon the individual items used to calculate that figure. Thus, the tax exempt status of income derived from c. 121A projects does not prevent the Legislature from using it as a part of the base on which the corporate excise tax is levied.

c. *Income from separate account business.* Each of the companies handles "separate account[s]" under G. L. c. 175, §§ 132F-132H. Section 132F provides that an insurer may, by written agreement with the holders of "pension contracts," assign "such contracts and the funds received thereunder, to one or more separate investment accounts, independent of its general investment account, for the purposes of allocating investment returns and asset gains and losses." Each year the insurers file an "Annual Statement" on Form 1 and an "Annual Statement" for the separate account business on Form 1-S. The Commissioner argues that the words "as reported in its annual statement" in § 22A refer to both forms. We disagree. There is no indication in § 22A that the Legislature

intended to refer to anything but the annual statement filed on Form 1. Consequently, the income reported on Form 1-S was properly excluded by the board.

d. *Miscellaneous items.* Items such as the fair rental value of home office buildings, earnings on assets held in connection with employee and agents' pension plans, and the amortization of Federal investment tax credits were all properly reported on exhibit 3 and, consequently, were required to be reported on the excise tax return. To the extent these items are not traditional items of income, it lends support to our conclusion that this is not a limited income tax, but rather a franchise tax.[10]

The decision below is reversed and the case remanded to the board for further consideration of the plaintiffs' applications for abatement consistent with this opinion.

So ordered.

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[10] Massachusetts Mutual reported management fees on exhibit 3. Although this item could have been reported elsewhere on the annual statement, it was not incorrect to report it on exhibit 3. State Mutual did not follow the instructions of the Commissioner of Insurance as to "ex-dividends."

It is incumbent on the companies to go back to the Commissioner of Insurance it they want to correct their annual statements. Neither company did so.

APPENDIX D

COMMONWEALTH OF MASSACHUSETTS.

SUPREME JUDICIAL COURT
FOR THE COMMONWEALTH,

AT BOSTON,

July 11, 1989

IN THE CASE NO. SJC- 4993

LIBERTY MUTUAL INSURANCE COMPANY

vs.

COMMISSIONER OF REVENUE
(and nine companion cases).

pending in the Appellate Tax Board
Court for the County of Suffolk No. 86036, 86037;
122512,
122513,
122514,
122515;
125133,
125134,
125135,
125136.

ORDERED, that the following entry be made in the docket; viz., –

Decision of the Board is affirmed.

So ordered.

By The Court,

Jean M. Kennett, Clerk.

July 11, 1989